ECONOMY

402 Cost-Sharing Programs

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Canadian Unity Information Office
Centre d'information sur l'unité canadienne

COST-SHARING PROGRAMS

THE BACKGROUND OF COST-SHARING, RECENT NEGOTIATIONS AND NEW FISCAL ARRANGEMENTS PREVAILING BETWEEN FEDERAL AND PROVINCIAL GOVERNMENTS.

INTRODUCTION

Financial arrangements that can be established between two levels of government within any federal state are crucial to its whole operation. These arrangements, in Canada, carry many labels: tax-sharing, revenue guarantees, equalization payments, cost-sharing, block-funding, assistance programs, etc. What do these terms mean?

In our present federal system, they mean a variety of things including the following: uniformity of corporate taxes across the country, flexibility for provinces to meet their own policy priorities, protection for the provinces against unpredictable changes in their revenues, and adequate levels of public service throughout the country.

The documents included in this kit have been selected in order to help you understand how the various cost-sharing programs developed, how they function and what they have achieved.

SELECTED DOCUMENTS

1. **The ABC's of Confederation: Sharing Canada's Wealth**, by John Honderich, in the Toronto Star, 18 December 1976.
2. **The New Federal-Provincial Fiscal Arrangements**, in the Monthly Review, The Bank of Nova Scotia, March/April 1977.
3. **Federal-Provincial Fiscal Arrangements and Established Programs Financing Act**, Department of Finance Press Release 77-22, Ottawa, 7 February 1977.
4. "Federal-Provincial Fiscal Reforms", Budget Paper B, **Ontario Budget 1977**, presented by W. Darcy McKeough, Treasurer of Ontario, 19 April 1977.
5. **Background to the Federal-Provincial Conference of Finance Ministers**, Department of Finance, Ottawa, 6-7 December 1976.
6. **Health Policy and Financing: Where Have We Come From?, Where Are We Going?**, notes for an address by Marc Lalonde to the Canadian Hospital Association, Quebec City, 11 May 1977.

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A. General

1. Bastien, Richard, **La Structure fiscale du fédéralisme canadien 1945-1973**, in l'Administration publique au Canada, Vol. 17 No. 1, 1974, pages 96-118.
2. Black, Edwin R., "Administrative Federalism", in **Divided Loyalties: Canadian Concepts of Federalism**, McGill-Queen's University Press, Montreal, 1975, pages 63-112.

*3. Courchene, Thomas J., **The New Fiscal Arrangement and the Economics of Federalism**, paper presented at the Conference on the Future of Confederation, University of Toronto, 14-15 October 1977.

*4. **Provincial and Local Taxation in Canada**, by John A. Hayes, Federal-Provincial Relations Office, Studies and Research Group, Government of Canada, July 1976.

5. Simeon, Richard, "The Financial Negotiations", in **Federal-Provincial Diplomacy: The Making of Recent Policy in Canada**, University of Toronto Press, Toronto, 1972, pages 66-87.
6. Smiley, Donald V., "The Fiscal and Economic Side of Canadian Federalism", in **Canada in Question: Federalism in the Seventies**, McGraw-Hill Ryerson Limited, Second Edition, Toronto, 1976, pages 114-158.
7. **Federal-Provincial Grants and the Spending Power of Parliament**, by Pierre E. Trudeau, Prime Minister of Canada, Government of Canada, working paper on the Constitution, Ottawa, 1969.
8. VanLoon, Richard J. and Michael S. Whittington, "The Historical Context: Federal-Provincial Finance from 1867-1974", in **The Canadian Political System, Environment, Structure and Process**, McGraw-Hill Ryerson Limited, Second Edition, Toronto, 1976, pages 209-226.

*9. **Federal-Provincial Fiscal Arrangements and Established Programs Financing Act**, 1977.

* Available upon request from the Canadian Unity Information Office

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B. **Specific**

1. Carter, George E., **Financing Post-Secondary Education Under the Federal-Provincial Fiscal Arrangements Act: An Appraisal**, in Canadian Tax Journal, Vol. XXIV, No. 5, September/October 1976, pages 502-522.
2. Carter, George E., **Canadian Conditional Grants Since World War II**, Canadian Tax Paper No. 54, Canadian Tax Foundation, Toronto, 1971.
3. Federal-Provincial Relations Office, **Federal-Provincial Programs and Activities**, a descriptive inventory as of June 1975, December 1975.

*4. **Opening Remarks by Marc Lalonde**, Minister of National Health and Welfare, to the Conference of Federal-Provincial First Ministers, Ottawa, 13 December 1976.

*5. **Extended Cost-Sharing in the Context of the Established Programs Financing Proposal**, letter from Marc Lalonde to all Provincial Ministers of Health and Welfare, Ottawa, 26 November 1976.

*6. **Fiscal Arrangements and Established Programs Financing**, statement by Donald S. Macdonald, Minister of Finance, Federal-Provincial Conference of Finance Ministers, Department of Finance Press Release 76-108, Ottawa, 6-7 December 1976.

*7. **Statement on Financial Implications of Recent Negotiations**, by W. Darcy McKeough, Treasurer of Ontario, Federal-Provincial Conference of First Ministers, Doc: 800-06/020, Ottawa, 13-14 December 1976.

8. Smith, Ernest H., **Allocating to the Provinces Taxable Income of Corporations: How the Federal-Provincial Allocation Rules Evolved**, in Canadian Tax Journal, September/October 1976, pages 545-571.
9. Strick, J.C., **Conditional Grants and Provincial Government Budgeting**, in Canadian Public Administration, Summer 1971, pages 217-235.

* Available upon request from the Canadian Unity Information Office.

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TORONTO STAR

December 18, 1976

THE ABC'S OF CONFEDERATION

by John Honderich

THE ABC'S OF CONFEDERATION

*The 109 years of tension between Ottawa and the provinces, known as Confederation, moved into a new phase this week. The premier-elect of Quebec, Rene Lévesque, who wants to lead his province out of Confederation, came to a federal-provincial conference, and Prime Minister Pierre Trudeau began talking of "decentralisation." What will happen next? Here Star staff writers provide a citizen's guide to the conflicts of Confederation -- in dollars and cents as well as in rules and regulations -- and tell where changes might come in federal-provincial arrangements.

SHARING CANADA'S WEALTH

by John Honderich
Star staff writer
OTTAWA

If Confederation means anything, Prime Minister Pierre Trudeau argues, it is to redistribute some of Canada's wealth.

This year the federal government will pay out roughly $9 billion in grants, loans, subsidies and cash transfers to try to balance the nation's income scales.

The process is a slow one "but it remains one of our prime roles," Trudeau told the 10 premiers at last Tuesday's conference of first ministers.

"We can't give up too much more without jeopardizing our role as redistributor of wealth between the rich and poor provinces."

But as Ottawa champions its part as Robin Hood, some provinces -- notably the rich ones -- are chomping at the bit for greater control over their own affairs and a bigger piece of the tax pie.

Both sides realize tax revenues can only be split so many ways.

As the premiers emerged from their closed session Tuesday, there were some disquieting rumblings from the poorer provinces that the pendulum may have swung too far in the provinces' favor.

New Brunswick's Richard Hatfield, for one, worried about Ottawa losing too much tax revenue.

"They have to have the resources to help bring up standards in the poorer provinces," he said.

Since emergency financial arrangements were made during World War II, Ottawa has had the lion's share of Canada's tax money.

The provinces have had to come, cap in hand, for help to pay for health and education programs.

Most agreed the balance was tipped too far in Ottawa's favor and since then the provinces have chipped away at the federal base, gathering up more tax revenue for themselves.

Trudeau has served notice that Ottawa has bent as far as it can.

To Alberta and British Columbia, this is nothing less than federal stonewalling.

More than $2.2 billion is paid out to the seven poorer provinces in the form of equalization payments. Only Alberta, Ontario and British Columbia receive no payments.

Ottawa has also picked up the tab to the tune of $5.3 billion for various shared-cost programs including hospital insurance, medicare, nursing homes, assistance to blind persons and to the disabled.

Until last week's agreement, Ottawa matched every dollar spent by the provinces. Under the revised rules, the formula will change but the provinces will receive $1.7 billion more by 1981.

All provinces receive additional grants if the money is spent on post-secondary education. This year Ottawa will dole out close to $1.5 billion.

Economically depressed regions of the country also receive $350 million under assistance programs administered by the Department of Regional Economic Expansion.

Toronto,
March-April, 1977

Monthly Review

THE BANK OF NOVA SCOTIA

The New Federal-Provincial Fiscal Arrangements

After a series of long and sometimes arduous negotiations, the federal and provincial governments achieved agreement last December on what is undoubtedly one of the most important milestones in the long history of intergovernmental financial arrangements in this country. The agreement, which has now been incorporated into federal legislation, and took effect on April 1, continues a basic structure of harmonized definitions and tax collecting arrangements that was begun over 35 years ago. But it also preserves the elaborate system of equalization payments directed towards the less favoured provinces; there are rather complicated measures to assure the relative stability of provincial government revenues; and (what is particularly noteworthy in this instance) it provides a major and much-needed disentangling of the responsibilities and financing for three major social programs in which there has been a formal sharing of costs between the federal and provincial governments: namely Hospital Insurance, Medicare and Post-Secondary Education.

The new legislation, which goes by the forbidding title of the *Federal-Provincial Fiscal Arrangements and Established Programs Financing Act, 1977*, is obviously a very comprehensive and complex affair. And its significance may also have been obscured by the political rhetoric which is an almost inescapable feature of negotiations among eleven sets of politicians, as well as by the deeper political concerns that have been raised by last November's election in Quebec. Yet the kind of financial arrangements that can be established within any federal state are crucial to its whole operation; and in a good many respects the new Canadian agreements constitute a most encouraging surge of progress in the long evolution of this country's federal-provincial relationship. It is thus the purpose of this REVIEW to try to throw some useful light and perspective on what has now actually been achieved, first through a brief tracing of significant historical background, and then through a discussion of some of the key issues involved.*

Cooperation in the Tax System

The present system for levying and collecting income taxes in Canada can be traced back in large part to the Wartime Tax Rental Agreements reached by the Government of Canada and the provinces in 1941. Those agreements themselves represented a kind of second effort in this area as they followed an abortive federal-provincial conference that had been called to consider the far-reaching proposals of the Rowell-Sirois Commission.† What emerged was a pragmatic adjustment to the prospective large requirements of the federal government for financing the Second World War. In the light of previous federal-provincial disagreements and provincial concerns not to forgo permanently their rights to the tax fields involved, these first agreements were explicity temporary in nature, scheduled to expire after the end of the war.

Thus, for a time, all provinces surrendered their constitutional right to impose personal income taxes and direct taxes on corporations. In return, the Government of Canada made rental payments, under several options which took some account of the special financial needs of those provinces whose revenue bases and debt loads were under particular strain.

A successor set of tax rental arrangements, much like the one reached during the emergency conditions of wartime, was negotiated in 1947, and with some later revisions it lasted until 1957. These tax rental agreements again were reached as a second try after some of the provinces had rejected a wide-ranging set of federal proposals presented in 1945-46 at federal-provincial conferences on postwar reconstruction.

In part, the thrust behind the changes actually made at this time related to the new thinking that had developed about the active use of fiscal policy as a key instrument in maintaining a high level of employment, thinking which included appropriate variations in tax rates as a task for a central government. There was federal concern, too, that the real benefits achieved under the wartime system by way of standardizing definitions and tax bases across the country should not be dissipated.

These rental payments were made to agreeing provinces on the basis of their choice of several options based on different mixtures of per capita payments and of a measure of "fiscal capacity" (i.e., the productiveness of the revenue

*The picture which a *Review* can give of this complex area is necessarily a broad-brush one. The reader interested in a fuller discussion of the background is referred to A. Milton Moore, J. Harvey Perry and Donald I. Beach, *The Financing of Canadian Federation: The first hundred years,* Canadian Tax Foundation, Toronto, 1966; to James H. Lynn *Federal-Provincial Fiscal Relations,* a study for the Royal Commission on Taxation, Queen's Printer, Ottawa, 1967; to George E. Carter, *Canadian Conditional Grants Since World War II,* Canadian Tax Foundation, Toronto, 1971; and to the papers on federal-provincial relations contained in the proceedings of the annual conventions held by the Canadian Tax Foundation. Recent developments have been covered in material published by many of the governments involved.

†This Commission, formally known as the Royal Commission on Dominion-Provincial Relations, had been set up as a result of the financial strains of the 1930s. Its recommendations were not accepted but its research and analysis have influenced much later thinking on federal-provincial relations.

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base which the province was surrendering). However, not all provinces were parties to these agreements. Quebec never entered into such an agreement; and Ontario only entered into one in 1952 when an additional more favourable option was provided to it.

Despite some attractive features, these agreements had several drawbacks. In particular the provinces which signed up, and those which did not, could receive quite differing treatment. Between 1947 and 1952, for example, neither Ontario nor Quebec imposed their own personal income taxes.* Yet neither province (nor their taxpayers) received any compensation for leaving this field as effectively open to the federal government as had the agreeing provinces.

After much political bargaining, a major redesign was therefore made with the Federal-Provincial Tax Sharing Act of 1957. These negotiations produced a system which bears much closer resemblance to the present one than did the old tax rental agreements. The big step taken was the clear-cut distinction drawn between tax rental payments (to provinces coordinating their tax bases and collection systems with those of the Government of Canada) and federal equalization payments to less favoured provinces.

Two alternative arrangements were devised to facilitate the joint occupation of the major direct tax fields in which both federal and provincial governments have constitutional rights. Under the tax collection scheme the federal government paid directly to each agreeing province three "standard taxes"–10% of federal personal income tax, 9% of corporate taxable income† and half of federal estate taxes on its residents. While the federal government administered tax collections for these provinces free of charge, it also fixed their tax rates and defined all the framework of their tax systems. For provinces which did not take part in the special tax collection system, the federal government provided for abatements corresponding to the "standard taxes," i.e. it reduced the schedule of federal tax rates imposed on their residents by the appropriate amounts.

Equalization payments (discussed in more detail later) were specifically separated from these tax-sharing arrangements. Thus a provincial government and its residents were as well off if the province did not take part in the federal collection arrangements as if it did; but against the freedom to set its own rates and its own tax schedules a province had to weigh the cost of setting up its own collection apparatus and the extra burden on its residents.

Quebec took full advantage of the abatement offered and set up its own complete collection system. Ontario entered into a collection agreement only in respect of the personal income tax, though it also adhered to the rules that had been worked out by the federal government and the agreeing provinces for allocating corporate income amongst jurisdictions. And after some revisions to these rules, Quebec moved several years later to rules which were for most purposes the same as those applied by the other Canadian jurisdictions.* Thus Canada has managed to avoid some of the manifold problems such as "discrimination, excessive costs of tax litigation, costly compliance and victimization of exposed businesses–and noncompliance by other businesses,"†which lack of uniformity of state corporate income taxes has produced in the United States.

The system established in the 1957 legislation has been amended quite a bit over the twenty years which have followed, mostly in the direction of a significant further withdrawal of the federal government from the personal income tax field. This federal withdrawal has undoubtedly not been as big as many of the provinces would have liked, but it has nevertheless helped to accommodate the provincial governments in their efforts to meet the large and growing demands for provincial and local expenditure characteristic of the postwar period. As well, provinces which take advantage of the federal government's willingness to administer the income tax system for them now have a good deal more flexibility than they did two decades ago.

Much of the progress in these directions came with the 1962 Act and with further negotiations in the years immediately following. As a result of the 1962 Act (which continued the pattern of renegotiations of federal-provincial fiscal arrangements at five-year intervals), the federal government reduced its own share of total personal income tax collections further. The standard abatement of personal income tax to provinces (which had risen from 10 to 13 percentage points in 1958 after a change of government at the federal level) rose from 13 per cent to 16 per cent in 1962; and further increases of one percentage point a year were scheduled for the next four years, bringing the total planned abatement to 20 percentage points of federal personal income tax by 1966. And following another change of government at the federal level it was arranged to add an additional permanent two percentage points to the abatement in each of 1965 and 1966, bringing it to twenty-four percentage points in 1966.

In 1962 also there was a formal and partly symbolic move away from a tax rental system which had made it difficult for provinces to set their own rates. Under the new arrangements, the Government of Canada continued to abate to the provinces a specified and standard percentage of a notional federal basic personal income tax. The federal government collected for itself this notional tax less the standard abatements made to the provinces (but plus certain surcharges which were not part of federal basic personal income tax). The federal government also collected personal income taxes for the nine provinces which had collection agreements with it at rates similarly specified as a percentage of the national federal basic personal income tax. But for the first time, the levels of taxes to be applied to residents of participating provinces were to be set by the province in question. Thus agreeing provinces were free to set their own tax rates, though these rates were in effect applied to personal income as defined for federal tax purposes and to a schedule laid down by the federal government. At the same time comparable arrangements were made in respect of corporate income taxes.

Only two of the provinces took quick advantage of their new ability to change tax rates while staying within the federal tax collection system. Most of them, for the shorter-term, preferred to develop other tax fields. In the last few years, however, most provinces have varied their tax rates. Now only Ontario, out of the nine provinces using the personal income tax collection facilities of the federal government, has not done so. And most of the provinces for which the federal government collects corporate income taxes have adjusted these rates too.

Since 1962 there have been no further wholly unconditional transfers of "tax room" to the provinces. An additional four percentage points of personal income tax and one point of corporation income were made available to all provinces in 1967, but this was related to

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*That these two provinces refrained from tilling this fertile field provides a striking indication of how much the financial demands on provincial governments have grown since the first years of the postwar period.

†Note that this transfer was 9% of corporate profits, not of taxes on corporate profits.

*Ernest H. Smith "Allocating to Provinces the Taxable Income of Corporations: How the Federal-Provincial Allocation Rules Evolved," *Canadian Tax Journal,* September-October 1976, pp. 545-571 gives a detailed history of developments in this area.

†James A. Maxwell and J. Richard Aronson, *Financing State and Local Governments,* 3rd edition, Brookings Institution, Washington, D.C., 1977, p. 125.

shared-cost spending in the field of Post-Secondary Education. With the 1972 Act, however, there was a change in the basis upon which provincial personal income tax is calculated. From 1972, provincial income taxes were expressed as a percentage of actual federal basic personal income tax due (rather than calculated on the basis of a notional federal basic tax from which abatements were subsequently subtracted). In part this change was to get around a possible implication of the abatement procedure that there was a "standard" and therefore especially appropriate level for provincial taxes. Also, in the wake of the Report of the Royal Commission on Taxation (the Carter Commission), the federal government's White Paper on Tax Reform and the long drawn-out process of discussion, a major reform of the income tax was instituted at the beginning of 1972. And to produce equivalent amounts of provincial revenue a technical rate adjustment was required. Thus the old standard federal abatement of 28 percentage points of federal basic personal income tax became a provincial tax rate of 30.5% of federal tax payable from 1972 to 1976.*

In 1972, also, it became possible for provinces using the tax collection facilities of the federal government to make a variety of changes to the structure of the personal income taxes they impose. Thus a province may now impose certain kinds of special surcharges or rebates on taxes above or below specified levels. And five of the nine provinces currently using the federal collection arrangements for the personal income tax have supplementary arrangements for special tax credit schemes, used for such purposes as offsetting the regressivity of provincial retail sales taxes. This kind of arrangement adds to the diversity of the personal income tax across the country. But it satisfies the desires of provincial governments for flexibility to meet their own policy priorities without requiring additional filings by individuals or costing the Government of Canada money or manoeuvrability.

Revenue Guarantees

In all the tax agreements made since 1941 the federal government has provided some assurance of a revenue floor to the provinces. In their modern form, such revenue stabilization efforts date back to the 1967 arrangements. Over the years this program has been extended in scope and with the 1972 Act there was provision for a deficiency payment to any province whose total revenues from all sources except the revenue stabilization program itself fell below the level reached in the previous year (after an adjustment to exclude the effects of any changes in tax rates). Since then, however, there has been enormous upheaval in world oil markets, and a good deal of volatility in commodity markets generally. In consequence, a special proviso has been inserted in the 1977 version of the Act limiting the federal government's exposure in the event of reductions in a province's revenues from natural resources. It is perhaps worth noting, however, that the federal government has never had to make any payments to provinces under the revenue stabilization program since its introduction in 1967.

The arrangement now specifically known as the Revenue Guarantee dates back only to the major changes in the tax structure introduced in 1972. To encourage a continuing national uniformity of the basic income tax system, the federal government guaranteed that no province would have smaller total receipts from personal and corporate income taxes under the new tax structure than it would have had under the previous one. The original offer was a guarantee for three years but after negotiations with the provinces it was extended for a full five-year period. This guarantee was later expanded to compensate provinces for the cost of following most federal changes to the income tax (a major exception being made for the indexing of the personal income tax structure that began in 1974). Current estimates are that payments to the provinces under the Revenue Guarantee in respect of the 1976 tax year will amount to around $870 millions, about half of this due to changes in the federal tax structure since 1972.

Not surprisingly, the future of this Revenue Guarantee was a major issue in the latest round of negotiations on the new federal-provincial arrangements. The Government of Canada argued that the Revenue Guarantee had explicitly been for a period of transition to the reformed tax system and that the provinces now had the experience needed to fix rates at the levels needed to produce revenue in line with their requirements. The provincial governments, by contrast, were naturally very interested in these unconditional funds being provided on a continuing basis so as to limit their recourse to explicit taxation of their own residents. Initially the provinces formed a common front to seek as compensation for the end of the Guarantee an abatement of four percent of federal personal income tax equalized to the yield in the highest province (i.e. with supplementary cash payments to nine provinces to make the per capita value of such an abatement in every province equal to its value in the wealthiest province).

The final result was one of the more interesting displays of public bargaining in Canada in recent years. In the end a last-minute compromise was reached. The federal government surrendered two percentage points of its personal income tax, half in cash and half as tax room (both equalized to the national average). The federal government presented this transfer as being in final settlement of all outstanding issues, but there can be no doubt that the Revenue Guarantee was the most important of these issues. As well, the federal government committed itself to pay for losses in provincial income tax revenue arising when a province follows a federal change in the personal income tax structure if the relevant provincial revenue loss is more than one per cent of basic federal tax in that province. This new guarantee applies only if the federal changes are announced after the beginning of a tax year to take effect in that same year.

This guarantee limits the exposure of provincial governments to unpredictable changes in their revenues arising from maintaining a uniform tax system. But it also limits the federal government's commitment to the first tax year in which a change is in effect. Initially this guarantee was to be only to the nine provinces for which the federal government collects personal income tax. After a request from Quebec, however, the guarantee was made available to that province also for instances when it changes its personal income tax in parallel with moves at the federal level.

Equalization Payments

For twenty years now, equalization payments have been made by the federal government to the provincial governments having lesser abilities to raise revenues from their own economies. The objective has been to facilitate the provision of a reasonably adequate level of public services across the country without some provinces needing to resort to levels of taxation which are excessively stringent by the standards of the richer provinces. Table 1 shows the current importance of these payments to the recipient provinces.

The equalization system is now based on a sophisticated "representative provincial tax system" which takes all provincial sources of revenue into account. Even local school taxes are included in recognition of a perceived national inter-

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*For the same reason, the four percentage points of personal income tax abated to provinces for Post-Secondary Education, but included in the 28 points of abated tax, changed to 4.357% of federal personal income tax.

Table 1.
THE GOVERNMENT OF CANADA'S
EQUALIZATION PAYMENTS 1977-78

Payments to:	Total ($ million)	Per Capita ($)
Newfoundland	269	479
Prince Edward Island	70	577
Nova Scotia	349	416
New Brunswick	276	394
Quebec	1262	200
Manitoba	201	194
Saskatchewan	39	41
TOTAL	2467	

Source: Treasury Board, Federal Expenditure Plan. How your tax dollar is spent, Ottawa, 1977, Table 22

Notes to Table:
1. Component figures do not add precisely to total because of rounding.
2. The figures are estimates of payments in respect of 1977-78, rather than final figures and do not include adjustments to be made during 1977 78 in respect of payments in previous years.

est in having children in lower-income provinces able to enjoy reasonable standards of public education. A province whose per capita revenue receipts from such a representative system are less than the national average per capita yield receives special federal payments equal to the per capita shortfall multiplied by its population.

This procedure was amended in 1974 after the escalation of world oil prices. In recognition of the windfall additions to the oil and gas revenues of producing provinces and in light of disruptions therefore developing to the existing arrangements, the equalization formula was changed so that only one-third of increases in oil and gas revenues above 1973-74 levels would be taken into account. With the 1977 Act a second amendment was made. The volatility of markets for resource products is now recognized in a more consistent manner, with only half of provincial revenues from all non-renewable natural resources being included in the equalization formula.

The unconditional—"no strings-attached"—nature of equalization payments is worth emphasizing. The equalization system, as well, is based on the measured ability of a province to raise revenues, rather than on the vigour with which it actually does tax its residents. A province could both have an unproductive revenue base and use that base relatively lightly by average standards—though the less affluent provinces generally do have relatively high tax rates.

Equalization payments can be considered as descendants of the unconditional "National Adjustment Grants" proposed in 1940 by the Rowell-Sirois Commission. One difference is that these grants were to be based on comparisons of both ability to raise revenues and cost of providing services with the national average (though the cost of providing average services would have been extremely difficult to measure). A second important difference is that the Rowell-Sirois Commission's recommendations were rejected by the three provinces which would not have received National Adjustment Grants whereas equalization payments are generally accepted today as an integral part of Canadian federalism.

Shared-Cost Programs

The final important area covered by the new legislation is the financing of some of the big programs whose funding is shared by federal and provincial governments—Hospital Insurance, Medicare, and Post-Secondary Education. Shared-cost programs have been used in a wide variety of fields, from transportation and agriculture to education and welfare, and have become one of the distinctive features of Canadian federalism. Indeed a comprehensive catalogue of federal-provincial programs and activities, the great bulk of which are shared-cost programs, is around one and one-quarter inches thick and more than 500 pages long.* However, much the largest part of activity under shared-cost arrangements is accounted for by the three programs covered by the new Act and by the Canada Assistance Plan (a welfare program whose future is currently the subject of negotiations between the federal and provincial governments).

The Government of Canada's position on shared-cost programs has generally reflected a broad perception of the national interest.† Part of the rationale for the expansion in 1967 of federal programs supporting Post-Secondary Education, for example, was bringing the superior resources and credit standing of the federal government to bear in an area where heavy financial pressures were developing on provincial governments. A part of the background to the federal presence in Hospital Insurance and in Medicare was a concern for such national standards as portability of coverage across provincial boundaries. A more general argument, too, has been that, because other provinces or the nation as a whole may bear some of the social and economic costs produced by a shortfall of public services in a particular province, there is a broad national interest in certain minimum services being provided in all provinces.

**A Descriptive Inventory of Federal-Provincial Programs and Activities*, Federal-Provincial Relations Office (59 Sparks St., Ottawa).

†*Federal-Provincial Grants and the Spending Power of Parliament*, Ottawa, Queen's Printer, 1969, a working paper produced as background to the 1969-71 negotiations on the Constitution, discusses shared-cost programs from a federal point of view and gives some references to the constitutional literature.

The public views of most provincial governments on shared-cost programs have been more mixed.* There have been objections (notably but not exclusively from successive governments of Quebec) about the appropriateness of federal spending in areas which for the most part the B.N.A. Act placed under provincial jurisdiction.† Much of the comment by provincial spokesmen, however, has focussed on the need for adequate consultation and on concerns about the distortions to provincial priorities which shared-cost programs can introduce. There have also been unhappy provincial comments on the administrative rigidities which shared-cost programs can involve. Detailed federal audits of provincial spending have been an irritant as well as a less-than-effective use of resources. Sometimes, too, particular kinds of outlays have been "sharable" but other closely related and more economical kinds of spending have not been sharable. (It is ironic though, that many of these items on the list of provincial complaints about the federal government are repeated in municipal discussions of provincial-municipal relations).

Analysts outside official circles, too have had mixed feelings about shared-cost programs and one of the biggest concerns has been about the blurring of the lines of official responsibility and accountability to the electorate.

In all of the four big shared-cost programs as they were set up through the late 1950s and the 1960s, the federal government essentially matched total provincial outlays on a dollar-for-dollar basis, despite variations in the exact arrangement from program to program. In both the Canada Assistance Plan and the Post-Secondary Education Arrangements, the sharing has been explicitly 50-50 on eligible outlays.‡ And for Hospital Insurance and Medicare the payments to provinces were calculated on a formula which takes national average per capita outlays into account. This

**Supplementary Papers on Federal-Provincial Finance*, presented to the Legislative Assembly of Ontario on March 28, 1972 along with that year's budget and prepared by the Ministry of Treasury, Economics and Intergovernmental Affairs, Taxation and Fiscal Policy Branch provides some provincial perspective on these questions as does the one of Budget Papers presented as part of the 1977 Ontario Budget.

†In the 1950s, in fact, Quebec refused to allow its universities to accept direct grants from the federal government, education being an area of provincial jurisdiction. And recognition of provincial concerns on this point explains why funds going to provinces as matching contributions from the Government of Canada for their spending on Post-Secondary Education have been described formally as unconditional grants, even though cost-sharing contributions are usually taken to be synonomous with conditional grants.

(‡see footnote overleaf)

difference, however, did not alter the open-ended nature of the commitments which the federal government had made.

The special "contracting out" mechanism negotiated in the mid-1960s through which Quebec has participated in several shared-cost programs (notably Hospital Insurance and the Canada Assistance Plan) also did not make a significant difference to this pattern.* Under these arrangements Quebec received additional abatements of personal income tax plus special adjusting cash payments to bring its total receipts to what they would have been if it participated in these shared-cost programs in the same way as the other provinces. But these abatements of tax points and cash adjustment payments were made to Quebec on conditions (such as those covering sharability of outlays and reporting requirements) operationally the same as those agreed upon by the federal government and the other nine provinces.

After these programs had got under way, the federal government became increasingly concerned about both the rapid growth in its outlays under them and the open-ended nature of its commitments. More and more federal officials came to be aware of some of the drawbacks to the matching payments mechanism, particularly that each provincial administration bore only about half of the burden of growth of its spending in the major share-cost programs. There still was a view that open-ended matching payments might have been an important element in the first years of a share-cost program. They were looked on as having been useful in encouraging the provinces to enter these programs and perhaps necessary in the period when levels of program activity and costs were still being established. But the situation was thought different for a "mature" program where costs were known with some degree of precision, where adequate levels of services were being provided and where provinces would continue to provide them. In these circumstances, the thinking was that the matching payments mechanism—and the so-called "fifty-cent dollar"—could well unbalance the priorities of provincial governments as between shared-cost items and other spending fields. It diminished the incentives for a provincial government to exercise the same care in controlling expenses in areas covered by shared-cost programs as was shown in other areas of activity.

At the same time, however, the Government of Canada could not simply walk away from its role of financially assisting provincial activity in these areas. It had, after all, encouraged provinces to move into some of them in the first place and there was a continuing desire to maintain some of the national standards—such as portability across provincial boundaries—which originally had encouraged federal participation. On several occasions in the last decade, therefore, the Government of Canada put proposals to the provinces which would remove the explicit linkage between provincial spending and federal contributions for some of the big shared-cost programs. The general idea was to relate growth in its grants to growth in some measure of the size of the economy or returns from the tax system.

One such proposal about transfers for Post-Secondary Education was made during the negotiations preceding the 1972 Act. The provinces did not accept it, largely as the result of unease about their potential exposure to rising program costs. The federal government, therefore, chose an alternative tack; and a limit of 15% to the increase in any one year of total federal contributions (abatements plus cash) for Post-Secondary Education was part of the package eventually emerging from the bargaining sessions. This limit has in fact put a ceiling on federal contributions in recent years.

Much the same sequence of events repeated itself in the fields of Hospital Insurance and Medicare. No agreement was reached in 1974 about analogous proposals for different arrangements for federal support of these programs. In 1975, therefore, the federal government amended the Medical Care Act to place upper limits on the annual increases in its contributions; and it gave five years notice (as required by the Hospital Insurance Act) of its intention to terminate the Hospital Insurance agreements with provinces in 1980. These unilateral federal measures were a big factor in the background to the recent federal-provincial negotiations.

With the limits on annual increases in its contributions the Government of Canada had partly dealt with problems of rapid growth in its spending on Post-Secondary Education and on Medicare. Yet the Hospital Insurance scheme still remained to be renegotiated. The method of arbitrary limits on increases in total federal contributions could produce inequities amongst the various provinces. In these circumstances it was

Table 2. FEDERAL SHARE OF ESTABLISHED PROGRAMS FINANCING, 1977-78
$ million

	Cash Payments				Tax Transfers					
Payments to:	Hospital Insurance	Medicare	Post Secondary Education	Sub-total	Direct	Equalization	Sub-total	TOTAL	Extended Health Care Transfer	GRAND TOTAL
Newfoundland	35	12	23	71	39	35	74	144	11	156
Prince Edward Island	7	3	5	14	8	8	16	30	2	33
Nova Scotia	56	20	37	113	74	36	110	223	17	240
New Brunswick	44	15	28	87	55	37	91	179	14	193
Quebec	470	167	305	941	731	92	823	1764	125	1890
Ontario	522	196	358	1106	1300	-	1300	2406	169	2575
Manitoba	69	25	45	139	114	22	136	275	21	295
Saskatchewan	61	22	39	122	100	24	124	246	19	265
Alberta	130	46	85	261	256	-	256	518	37	555
British Columbia	147	52	96	295	385	-	385	680	51	731
TOTAL	1572	558	1020	3150	3061	254	3315	6465	467	6932

Sources: Treasury Board, Federal Expenditure Plan: How your tax dollar is spent, Ottawa, 1977. Table 22.
Minutes of Proceedings and Evidence of Standing Committee of House of Commons on Finance, Trade and Economic Affairs, March 8, 1977, Appendix "FTE-12".

Notes to table:

1. Component figures may not add exactly to totals because of rounding.
2. Under the new arrangements for financing established programs, the federal government's contribution is not specifically linked to provincial outlays. The distribution of the cash payments amongst the programs, therefore, is necessarily arbitrary; the figure here for each program is based on its share of the total for the three programs in the 1975-76 fiscal year.
3. The figures are estimates for 1977-78 rather than final figures and do not include adjustments to be made during 1977-78 in respect of payments during previous years.
4. The direct tax transfer consists of an abatement of 13.5 percentage points of federal personal income tax and one per cent of taxable corporate income. The equalization payments associated with these taxes and shown in this table are also included in the equalization payments shown in Table 1.
5. The cash amount for Quebec includes the value of a personal income tax abatement to place the figure on the same basis as those for the other provinces.

‡While the big part of the federal contribution to Post-Secondary Education was in the form of tax abatements, there were adjusting cash payments to bring total provincial receipts up to the 50% share. The one point of corporate income abated to the provinces for Post-Secondary Education is something of a historical relic. Originally one point of corporate income had been abated to Quebec in 1960 as a substitute for the direct federal grants made to universities in the other provinces. It was extended to all provinces in the mid-1960s when the federal government moved to expand its total support of post-secondary education and harmonize its support of universities and other forms of post-secondary education; and university grants were dropped. The personal income tax has, however, been found more suitable than the corporate income tax for abatement to provinces because its yield is not as cyclically volatile and it has a stronger underlying trend of growth.

*Originally, the "opting out" arrangements were intended to be temporary; a permanent resolution, however, was delayed by tax reform and by negotiations between the federal government and other provinces about these same programs.

hoped that negotiated arrangements would clear the air for future federal dealings with the provinces. And there was a feeling that it would be desirable to have some sort of a per capita element in the federal contributions to the shared-cost programs, partly to take additional account of the position of the less prosperous provinces.

Some of the provinces, too, came to the bargaining table with specific aims in mind. Since the 1960s, a number of them had become more interested in a restructuring of the major share-cost programs under which they would take on more of the policy-making and administrative responsibilities, in return for extra tax room.* The hope was that the provinces would be enabled to manage these programs (especially health programs) more effectively with such enhancement of their authority. The approach to a reworking of the shared-cost arrangements did, of course, vary from province to province. Some of the more affluent provinces focussed especially on tax room whereas some of the less affluent ones were rather more interested in cash payments from the federal government. But at the meetings of First Ministers in the summer of 1976 more than half of the provinces expressed their interest in greater responsibilities coupled with increased federal tax abatements.

The New Financing Arrangements

It was out of all these considerations that an agreement was reached last December on new financing arrangements for the major shared-cost programs other than the Canada Assistance Plan. Contributions from the Government of Canada will no longer be directly related to provincial expenditures, but instead will rise with the growth of the economy. Conversely, the provincial governments' receipts in respect of these programs will no longer be tied to their outlays in the specific areas concerned, although the provinces have committed themselves to continue to meet certain standards in some key respects.

About half of the federal contribution now will be in cash with the rest to be in abated tax room. In time the cash payments to each province will come to be determined by a formula using half of the national average per capita federal payments in a 1975-76 base period, escalated by a moving average of growth rates for per capita Gross National Product. For the shorter term, there will be some temporary adjustments to bring the move to a uniform scale of payments into effect gradually. And in addition, the basic cash payments will be supplemented by a further unconditional payment equivalent to one percentage point of personal income tax and, where applicable, associated equalization.

As for the tax portion of the federal contribution, it is to consist of 13.5 percentage points of federal personal income tax plus one point of corporate income, as well as associated equalization where this is applicable.* In addition, because transfers of tax rights have a below-average value in some provinces, the federal government will make special transitional payments. Therefore each province will receive at least as much revenue transfer as it would have were the transfers all worked out on the cash basis discussed above (rather than being half tax and half cash).

Eventually receipts from transferred tax room should catch up with the value of the cash payments since personal tax revenues grow faster than the economy as a whole, the escalator used for the cash transfers. During the interim period when the transitional support payments are being made, however, the wealthier provinces will enjoy faster growth in their net receipts from Established Programs Financing.

It is also worth noting that the supplementary cash payment (that is equivalent to one percentage point of personal income tax) and one of the percentage points of abated personal tax–both of them formally ascribed to Established Programs Financing–are in fact the same two percentage points of personal income tax which, as discussed earlier, were traded off at the December meetings in settlement for the ending of the full Revenue Guarantee provision and for other outstanding issues.

Finally a special arrangement has been devised to provide the provinces with cash payments under an Extended Health Service Program. The purpose of these payments (to be made on a per capita basis and to be escalated by growth in per capita GNP) is to assist the provinces in providing supplementary kinds of services in the health care field, such as home care or residential care, to complement the other kinds of services which in the past were financed under Hospital Insurance and Medicare. This new program updates a federal offer made during earlier discussions about methods of controlling health care costs; in part payments under it will replace federal shared-cost contributions for the provision of such services to persons in need under the Canada Assistance Plan.

A Summing Up

If only these changes to shared-cost arrangements are taken into account, the dollars and cents position of the provinces as a group has improved substantially. Counting the equalization payments associated with the transferred tax points, the federal contribution for 1977-78 will be $924 millions higher than it would have been if the old rules had remained in effect; and the difference will grow over time. Against this, at least some of the provinces would set the end of the Revenue Guarantee–almost $900 millions in 1976–which they had hoped to keep operative. Thus the new agreement can be interpreted as being pretty much a saw-off. It is also true that the old rules for shared-cost programs would not always have been as favourable to the provinces as they have till now. The federal government, after all, had given notice of its intention to end the previous agreement for Hospital Insurance in 1980. At that time a new agreement placing some constraints on growth in the Government of Canada's contributions would have been likely.

In other ways, the new arrangements are distinctly more satisfactory for both federal and provincial governments. The Government of Canada now has clearly defined obligations for its contributions in support of three of the major shared-cost programs, and these obligations are the result of a bargaining process rather than an imposed solution. It also has the assurance that the provinces will continue to maintain standards in such facets of these programs as portability and degree of coverage.

Each province has a good deal more scope for defining its own programs without forcing them to fit exactly into rigid categories found acceptable by the federal-provincial bargaining process. The mixture of income taxes and cash payments gives an assurance of continuity and predictability in provincial receipts and reflects the interests of both the wealthier and the less prosperous provinces. There will no longer be detailed federal monitoring and auditing of provincial outlays. And because there is no longer dollar-for-dollar federal matching of provincial spending, any progress a provincial government is able to make in containing the growth of its spending in these shared-cost areas will be completely, rather than half, reflected in a betterment of its fiscal position. All told, the new arrangments are an entry on the constructive side of the national ledger.

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*See, for example, the Ontario documents cited earlier.

*These abatements thus include the 4.357 percentage points of personal income tax and one percentage point of corporate income previously made available to the provinces for Post-Secondary Education.

Release

Communiqué

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77-22

Federal-Provincial Fiscal Arrangements and Established Programs Financing Act

Legislation transferring $8.5 billion in cash and taxing power to provincial governments was introduced today in the House of Commons by Finance Minister Donald S. Macdonald.

The legislation provides authority in law to implement the federal-provincial financial agreements reached by the First Ministers in December, as well as a number of related decisions taken more recently.

The main items contained in the new Federal-Provincial Fiscal Arrangements and Established Programs Financing Act, 1977:

Part I - Equalization - Renewal with modifications of the program of annual payments to provinces having below-average per capita capacity to raise revenues, in order to help them provide public services.

Part II - Revenue Stabilization - Renewal of the program which provides payments to any province if its revenues decline due to a downturn in economic activity.

Part III - Tax Collection Agreements - Continuation of the central system under which the federal government collects free of charge personal and corporate income taxes levied by provinces which adopt a uniform tax system.

Part IV - <u>Revenue Guarantee</u> - A new year-by-year guarantee to protect provinces against any major income tax losses arising from personal income tax changes by the federal government.

Part V - <u>Undistributed Income on Hand</u> - The provinces continue to share the elective tax on the 1971 undistributed income of corporations.

Part VI - <u>Established Programs Financing</u> - A <u>new</u> system of tax and cash transfers replacing the previous cost-sharing arrangements for federal contributions to medicare, hospital insurance and post-secondary education. The legislation also introduces provision for new contributions to extended health care services.

Part VII - <u>Alternate Payments for Standing Programs</u> - Replacing the Established Programs (Interim Arrangements) Act - "contracting-out" - under which Quebec received a special abatement of 24 personal income tax points for Youth Allowances, Special Welfare and Hospital Insurance. Because of a general federal tax reduction the abatement will be reduced to 16.5 personal income tax points in order to have the same net effect, on the Government of Quebec and Quebec taxpayers following introduction of the new Established Programs Financing.

Part VIII - <u>Provincial Taxes and Fees (Reciprocal Taxation)</u> - Authority is provided for federal-provincial agreements whereby provinces pay federal consumption taxes on their purchases of goods and the federal government makes payments in lieu of provincial consumption taxes and fees on its purchases of goods and services.

Part I: Equalization

Equalization is a program of annual federal payments to provinces that are below the national average per capita in their capacity to raise revenues from their own sources. In effect, the payments help to alleviate regional income disparity and are intended to enable lower-income provincial governments to provide services to the public at reasonable standards without having to resort to excessive rates of taxation.

The present equalization system of payments is extended with the following modifications:

(1) The present formula, known as the "representative tax system", has been redefined to better reflect what the provinces are now taxing. This has involved a reclassification of the revenues that are equalized so that they fall into 29 groups (referred to as "revenue sources") rather than 22 as at present. Among other things, this change enables the formula to give separate recognition to tobacco taxes, payroll taxes, lotteries and insurance premium levies which have become of increasing importance in recent years. In addition, numerous changes have been made in the measures of fiscal capacity (referred to as "revenue bases") for equalizing the 29 groups of revenue. The revenue bases are complex and technical; they continue to be defined in regulations.

(2) The treatment of natural resources has been changed. Commencing with 1974-75, provincial revenues from natural resources have been only partly included in equalization. It is proposed to continue to restrict the resource revenues subject to equalization but to do so in a more consistent way. At the present time, revenues from minerals are equalized in full, while oil and gas revenues are split into two parts - "basic" and "additional" - with basic revenues equalized in full, and additional revenues (essentially the increase in revenues beyond 1973-74 levels) equalized to the extent of one-third only. The new formula equalizes one-half of all revenues

from non-renewable resources (minerals, oil and gas). Provincial revenues from renewable resources (e.g. forestry and water power) would continue to be equalized in full.

(3) Changes have been built into the formula to reduce existing possibilities for equalization entitlements of a province to be influenced arbitrarily by its own actions. A new revenue source, "business income", combines provincial revenues from the incomes of both private sector and public sector enterprises. This change is intended to prevent a province's equalization entitlement from being increased as a result of its having acquired a privately-owned, profit-making corporation.

(4) A partial ceiling has been built into the equalization formula relating to natural resource revenues. The total amount of equalization payable in respect of natural resource revenues (including both renewable and non-renewable resources) may not exceed one-third of total equalization. The level of one-third is somewhat above the existing level and is unlikely to become applicable unless there is a very substantial increase in provincial revenues from oil and gas.

Part II: Fiscal Stabilization Payments

This involves unconditional payments to any province whose total revenues fall short of its previous year's total due to a downturn in economic activity. No payments have been made to the provinces since the program was introduced in 1967 as provincial revenues have risen steadily. However, the program has proved useful to provinces in borrowing, particularly when they have resorted to foreign capital markets.

The program is renewed but federal liability is limited by a threshold in respect of natural resource revenues. Stabilization will be payable in respect of resource revenues only to the extent that a year-to-year decrease exceeds 50 per cent. This provision prevents the possibility

of making substantial stabilization payments to resource-rich provinces whose revenues could fall from present or future high levels as a result of declining volumes of production or reductions in the prices of their resources.

Part III: Tax Collection Agreements

Since 1962, personal and corporate income taxes in most provinces have been collected by the federal government under uniform federal rules. The new Act authorizes the federal government to enter into collective agreements not only with the provinces, but with the two Territories as well.

Part IV: Revenue Guarantee

The guarantee encourages maintenance of a common tax system across Canada. It commits the federal government to pay for any loss in provincial income tax revenue as a result of federal changes in personal income taxes that exceed 1 per cent of federal basic tax in the province. The guarantee applies to all changes announced after the beginning of the tax year and effective in that year. It does not apply to corporate income tax.

The Province of Quebec collects its own personal income tax, and would not be directly affected; however, if Quebec makes a similar change in the same year, a similar payment will be made.

Part V: Undistributed Income on Hand

These provisions extend the arrangement for provinces to receive a share of the elective tax on 1971 undistributed income of corporations. The tax relates to retained profits earned prior to tax reform in 1972. Payments will decline and eventually disappear but this may take some time since the disbursements are influenced by the liquidity requirements of corporations. For this reason the program has no time limit. By March 31, 1977, nearly $50 million will have been paid to the provinces.

Part VI: Established Programs Financing

The new agreement replaces the cost-sharing arrangements for medicare, hospital insurance and post-secondary education, and incorporates certain extended health care services options. Under the new agreement federal contributions will grow with the growth of the economy rather than with the growth of provincial expenditures. Federal contributions will take the form of a tax transfer - a reduction of federal taxes to allow an equivalent increase of provincial taxes - and cash payments.

The new agreement is intended to maintain national objectives and standards of services; put financing on a more stable footing to help financial management at both levels of government; give provinces more flexibility in the use of their own funds; provide greater equality among the provinces with respect to the amount of federal funds they receive.

In this agreement, the federal government will transfer to the provinces 13.5 percentage points of personal income tax plus one percentage point of corporate tax. This includes the 4.357 personal and one corporate tax point previously transferred for post-secondary education. This represents an additional transfer of 9.143 points.

There are three parts to the federal government's cash contribution: the basic contribution, transition payments, and a levelling adjustment. The basic contribution provides stable cash funding to the provinces. The amount is one-half the national average per capita federal contribution in the base year (1975-76) increased by the escalator (the three-year compound rate of growth in the GNP). The basic cash amount is further increased by the value of the one point of personal income tax and associated equalization. This plus an additional point as a tax transfer was added as part of the agreement among First Ministers in December.

The federal government will make levelling adjustments in cash payments so that provinces where federal contributions now are above the national average in per capita terms will be brought to the national average in

five years; provinces where federal contributions are now below the national average will be brought up to the national average in three years. Subsequently basic cash payments will be equal per capita in all provinces.

Because the value of tax transfers differs between provinces, transitional payments will be made to ensure that all provinces receive at least as much in tax plus cash as if the entire transfer were in cash. These payments should gradually disappear since provincial tax yields grow more rapidly than the economy and the cash transfer.

With regard to Hospital Insurance and Medical Care, this part of the legislation involves a change in the method of financing the federal contribution to these programs. These new arrangements will provide the provinces with greater flexibility in the use of their own funds, while safeguarding the national standards now applied to the hospital insurance and medical care programs: comprehensiveness of coverage with regard to services, universality of coverage with regard to people, portability of benefits, accessibility to services uninhibited by excessive user charges, and non-profit administration by a public agency.

In addition, the Bill includes provision to compensate the provinces for extended health care services, including nursing home intermediate care, adult residential care, converted mental hospitals, home care (health aspects), and ambulatory health care services. The Bill includes sections dealing with two aspects upon which decisions are still open pending the outcome of discussions with the provinces: 1) the mechanism to be used to determine the provincial entitlement under the Hospital Insurance and Diagnostic Services Act for the first quarter of 1977; and 2) the quantum of the per capita transfer for the Extended Health Care Services, and whether or not room and board, clothing, comforts and non-insured health benefits to persons in need would continue to be shared under the Canada Assistance Plan. Amendments may have to be introduced during the legislative process if the Bill as tabled, does not reflect the consensus of the provinces on these points. The Secretary of State will meet regularly with provincial education ministers to discuss matters of mutual interest and concern.

The new financial agreements will continue indefinitely. Changes will require agreement on three years' notice, and the Government of Canada has agreed not to give such notice before April, 1979.

Part VII: Alternate Payments for Standing Programs (Contracting Out)

In the mid-1960s, arrangements were made with Quebec to assume administrative and financial responsibility for certain joint programs in return for an abatement of personal income tax points. For hospital insurance, 16 income tax points were abated; for the special welfare program, including the Canada Assistance Plan, 5 points were abated; and 3 points were abated for youth allowances - for a total of 24 points. In 1973, the youth allowance program came to an end and the value of 3 points has since been deducted from other payments owing to Quebec.

The total contribution to Quebec under these programs was the same as if it had been under the cash payment arrangement with other provinces.

Under the new fiscal arrangements this special abatement will be reduced in order to leave the Quebec taxpayer in the same position before and after the federal personal income tax cut of 9.143 per cent. The 24-point abatement to Quebec will be reduced by the 9.143 points transferred to all provinces to 14.857. Since the federal tax base on which the abatement is calculated is reduced, this new abatement is equivalent to 16.5 per cent of the new, smaller federal tax base. The 16.5 points will be allocated as follows:

> 3 points for Youth Allowances,
> 5 points for Special Welfare, and
> 8.5 points for Established Programs Financing.

Part VIII: Provincial Taxes and Fees (Reciprocal Taxation)

The federal government and six provinces (Ontario, Quebec, New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland) have approved a federal-provincial system of reciprocal taxation on consumption taxes.

Under the system, the provinces will agree to pay federal sales taxes on their purchases of goods and the federal government will make payments in lieu of provincial sales taxes, gasoline taxes and motor vehicle licence fees on its purchase of goods and services, and for federal vehicles operating in these provinces.

Under the existing sales tax arrangements generally, the provinces do not bear the indirect federal sales tax and the federal government does not pay the direct sales taxes of the province.

The system will take effect on October 1, 1977 and the initial agreement, with provisions for renewal, will terminate on March 31, 1981. On a full fiscal-year basis, the six provinces will pay an estimated $75 million in federal sales taxes while the federal government will pay $100 million in provincial taxes and motor vehicle licence fees.

This new arrangement has been developed over the past several years in co-operation with the provinces, in response to many federal-provincial problems which have arisen with respect to the intergovernmental application of sales taxes. The arrangement will help establish the principle that the government sector should pay the same taxes on its economic activity as the private sector.

Part IX: General

The tax transfer that occurs as part of the new financing arrangements for medicare, hospital insurance and higher education takes place effective January 1, 1977 - with federal taxes dropping by 9.143 per cent, and provincial taxes increasing by the equivalent amount. However, the actual conversion of the three programs takes place April 1, 1977. This results in the accrual of a three-month overpayment of tax revenue to the provinces. On the other hand, because of the lag between accruals and payments under the tax collection agreements, provinces begin receiving the benefit of the "overpayment", only in March, 1977. A somewhat different adjustment will be made with Quebec as a result of its special arrangement in hospital insurance. To settle this transitional

problem, the bill proposes that only half of the three-month overpayment will be recovered by the federal government. The full recovery would involve over $700 million. The proposal would recover about $350 million.

Part X: Consequential Amendments

Part of the Established Program Financing (EPF) program consists of a "tax transfer" to the provinces. This transfer essentially involves a reduction in federal income tax revenues matched by an offsetting increase in provincial income tax revenues, thus leaving the total tax burden on taxpayers unchanged. The EPF agreement stipulates transferring 13.5 points of personal income tax and one point of corporation income tax in respect of the established programs. However, the proposed transfer includes the 4.357 personal income tax points and one corporation income tax point that were first transferred in 1967 under the Post-Secondary Education arrangements and which are currently reflected in federal collections. Thus the net additional transfer consists of 9.143 personal-income-tax points.

There are basically two adjustments to the federal Income Tax Act necessitated by the transfer. First, the federal tax rates have to be lowered by 9.143 per cent. Second, the federal tax-cut rate has to be increased from 8 per cent to 9 per cent (rounded up from 8.81 per cent) to maintain the value of the tax cut. The tax cut is expressed as a percentage of the basic federal tax which will now be lowered by 9.143 per cent. The proposed increase in the rate is necessary to offset the effect of the decline in the base, thereby leaving the value of the tax cut unchanged.

These amendments are essentially consequential in nature and reflect a simple arithmetic conversion of the various rates currently used to compute the federal tax payable. The amendments proposed deviate slightly from a strict arithmetic adjustment due to rounding adjustments which are necessary in order to avoid complexity. The revenue implications of these deviations are negligible.

Other consequential amendments relating to the dividend tax credit and the territorial tax rate will be dealt with later in the session.

1977 FEDERAL INCOME TAX RATES

Taxable Income			Tax	
$710 or less			6%	
In Excess of				
$ 710	$ 43	+	16% on next	$ 709
$ 1,419	$ 156	+	17% on next	$ 1,419
$ 2,838	$ 397	+	18% on next	$ 1,419
$ 4,257	$ 653	+	19% on next	$ 2,838
$ 7,095	$ 1,192	+	21% on next	$ 2,838
$ 9,933	$ 1,788	+	23% on next	$ 2,838
$12,771	$ 2,441	+	25% on next	$ 2,838
$15,609	$ 3,150	+	28% on next	$ 4,257
$19,866	$ 4,342	+	32% on next	$14,190
$34,056	$ 8,883	+	36% on next	$21,285
$55,341	$16,546	+	39% on next	$29,799
$85,140	$28,167	+	43% on remainder	

Budget Paper B

Federal-Provincial Fiscal Reforms

Table of Contents

Federal-Provincial Fiscal Reform

Introduction

At their historic meeting in December 1976, the First Ministers laid the foundation for the "Federal-Provincial Fiscal Arrangements and Established Programs Financing Act" that was recently passed by the Parliament of Canada. This Act sets out the basic intergovernmental arrangements that will exist for at least the next five years, and as such, testifies to the fact that considerable progress has been made in terms of rationalizing the financial structure of Confederation. Among other things, it incorporates a compromise on the problem of the Revenue Guarantee, provides for an improved equalization formula, and spells out new arrangements which replace the shared-cost programs in the fields of health and post-secondary education. All told, the legislation affects over $12 billion in combined federal and provincial spending.

It is the purpose of this paper to describe the changes that have been brought about. Section I reviews the steps leading to the adoption of the new arrangements, concentrating on the issue of the shared-cost programs. Section II goes on to describe the new arrangements that were agreed upon in December, and Section III explains the mechanics of the resulting tax transfer, showing what it means for Provincial tax rates and representative taxpayers. The paper concludes with a technical appendix detailing the method by which federal contributions to the provinces will be determined commencing April 1, 1977.

I The Process of Reform

The three "established programs" at the centre of discussion in 1976 were Hospital Insurance, Medicare, and Post-Secondary Education.[1] This section reviews the structure of the old arrangements, the problems that were perceived to exist with them, and the steps leading to the new arrangements.

The Established Programs

Under the British North America Act, the provinces have exclusive constitutional jurisdiction over the fields of health and education. During

[1] Federal contributions to the provinces were authorized under the Hospital Insurance and Diagnostic Services Act (1958), the Medical Care Act (1968), and the Federal-Provincial Fiscal Arrangements Act (1967, 1972).

the 'fifties and 'sixties, however, the federal government moved into these areas, at its own initiative, for reasons of "overriding national importance". With regard to health care, the overriding consideration was the perceived need to develop a public system of hospital and medical insurance, providing all Canadians with a "national standard of service". With regard to post-secondary education, it was the perceived need to push supply beyond the point that the provinces could themselves afford. The vehicle chosen for federal involvement was cost sharing rather than increased tax abatements to the provinces.[2] By 1976-77, federal contributions to the three shared-cost programs in question totalled nearly $5.3 billion, or 12.5 per cent of federal budgetary expenditures. An overview is provided in Table 1.

Federal Contributions to Established Programs in 1976-77 — Table 1

	HIDS	PSE	Medicare	Total	Per Capita
		($ million)			($)
Newfoundland	63.2	31.3	23.1	117.6	211
Prince Edward Island	12.0	6.9	5.0	23.9	199
Nova Scotia	95.4	57.5	34.6	187.5	225
New Brunswick	77.6	38.9	28.6	145.1	211
Quebec	729.5	602.0	259.6	1,591.1	255
Ontario	987.0	618.3	346.7	1,952.0	234
Manitoba	122.6	64.2	42.7	229.5	223
Saskatchewan	105.0	57.0	38.9	200.9	215
Alberta	210.5	137.6	75.9	424.0	232
British Columbia	288.7	145.4	103.6	537.7	216
All Provinces	2,691.5	1,759.1	958.8	5,409.3	234

Source: Department of Finance, Government of Canada, November, 1976.

Each program had its own sharing formula. Under the Hospital Insurance Agreements, provinces recovered 25% of their own per capita cost on an approved range of services, plus 25% of the national average per capita cost. Under Medicare, they received a straight 50% of the national average per capita cost. Under the post-secondary arrangements, seven provinces received 50% of their actuals costs while Newfoundland, P.E.I. and New Brunswick recovered somewhat more by virtue of being on a more generous per capita formula.[3] The particular formulas notwithstanding, it is fairly accurate to say that, *overall*, the federal government paid 50% of the provinces' approved operating

[2]Although increased tax abatements were provided in the early 1960s, this approach to redressing the fiscal imbalance between the federal and provincial governments was soon abandoned in favour of expensive new shared-cost programs and enriched equalization grants. See, "Statement of the Hon. Mitchell Sharp to the Federal-Provincial Tax Structure Committee", Sept. 14-15, 1966.

[3]In 1967, these three provinces opted for $15 per capita, cumulatively escalated by the national average rate of increase of post-secondary education spending.

expenditures (at least prior to the ceilings that came into force in the middle 'seventies).[4]

The federal contributions in respect of Hospital Insurance were paid in cash to all provinces except Quebec, which received most of its payment in the form of an additional income tax abatement under the Established Programs (Interim Arrangements) Act.[5] Federal contributions towards Medicare were paid in cash to all provinces. Contributions in respect of post-secondary education were paid in the form of a tax transfer consisting of 4 points of personal income tax (converted in 1972 to 4.357 points of reformed tax) and one point of corporate income tax, plus a cash adjustment payment to bridge the difference between the value of the tax room and the full entitlement. The Quebec and post-secondary arrangements were, in a broad sense, precursors of the new arrangements insofar as they incorporated the idea of a tax-cash split.

Problems and Objectives

The problems with the shared-cost funding mechanism have been extensively examined.

From Ottawa's point of view, there were two major concerns. The first was that the federal government had no effective control over its payouts; it assumed responsibility for 50% of whatever the provinces chose to spend on the approved services. This was a legitimate concern, especially in view of the inflationary problems that beset the international and Canadian economies during the 1970s. In 1974-75, federal contributions to the three programs in question were 17.9 per cent higher than they were in the preceding year, and in 1975-76 they were 18.2 per cent higher than in 1974-75.[6]

The other problem, as seen by the federal government, was that its contributions on a per capita basis were quite different from province to province. The degree of the disparity is revealed in Table 1. This situation arose because certain provinces did not, or could not, spend as

[4]One peculiarity of the HIDS and Medicare formulas was the existence of "implicit equalization". Provinces that were spending above the national average rate per capita, like Ontario, recovered less than 50% of their actual costs, while those that were spending below recovered more than 50%. The three provinces on the per capita formula for post-secondary education were also "implicitly equalized". The term refers to the fact that, under the sharing formulas, certain provinces received differential assistance over and above their explicit equalization payments (which presumably *already* lifted them to a national average fiscal capacity position).

[5]For the period 1972-77, Quebec's HIDS tax abatement was set at 16 unequalized points of federal tax in the province. Quebec still had to file expenditure data, and a cash adjustment was made to ensure that the value of its abatement was neither more nor less than its entitlement.

[6]The 15% growth ceiling on federal contributions to post-secondary education, imposed in 1972, was already constraining these percentages somewhat. The numbers of course reflect the fact that the provinces were also experiencing similar and often unforeseen spending pressures.

much as others on their own account. Disregarding the fact that demand and cost pressures differ from province to province, the federal government took the view that differential per capita contributions were inherently inequitable, and the "levelling" of contributions became, after restraint, its second basic objective.

The provinces' views on the shared-cost arrangement varied considerably. At one end of the spectrum were Ontario, Quebec, and perhaps Alberta. While recognizing the past achievements of cost sharing, Ontario argued that there were serious drawbacks to continuing federal assistance in this form. Ontario's objections could be summarized as follows[7]:

- *Cost sharing causes distortions in provincial priorities.*
  Provinces are tempted to spend in the high cost-shareable forms of service when in fact they should be spending on lower cost but non-shareable alternatives. (This was a particularly serious concern in the area of health care, since about 20 per cent of provincial expenditures on health were not eligible for federal reimbursement).
- *Cost sharing involves too much bureaucracy.*
  Provincial expenditure data has to be compiled in a detailed and specified manner and then checked and approved by federal auditors.
- *There are undue delays in the settlement of accounts.*
  Some provinces have experienced as much as a seven-year delay in the finalization of their post-secondary education claims.
- *Cost sharing causes administrative distortions.*
  The sharing legislation often requires that a particular service be delivered by a particular provincial ministry, when in fact the province would, for its own reasons, prefer it to be delivered by some other ministry.
- *Unilateral changes or withdrawals of federal sharing leave the provinces with an unfair and unexpected burden.*

At the other end of the provincial spectrum were the Atlantic Provinces and Saskatchewan. They recognized that there were indeed problems to resolve, but feared that any departure from 50-50 cost sharing would saddle the provinces with an unfair share of financial risks, and, in addition, lead to a deterioration in national standards of service.

These, then, were the starting points: the federal government's desire to constrain its contributions and level them on a per capita basis, and the provinces' desire to achieve more streamlined arrangements, while at the same time preserving national standards and an "adequate" level of support.

[7]For a discussion of these problems see, Hon. W. Darcy McKeough, *Supplementary Papers on Federal-Provincial Finance* (Toronto: Ministry of Treasury, Economics and Intergovernmental Affairs, 1972); and, Hon. W. Darcy McKeough, *Supplementary Actions to the 1975 Ontario Budget* (Toronto: Ministry of Treasury, Economics and Intergovernmental Affairs, 1975).

The Course of the Negotiations

The move to new financial arrangements began in 1970 when the federal government first indicated its concern over escalating contributions and suggested that it would like to restrict the growth of its contributions to the rate of growth of GNP. In the following years, various federal proposals incorporating a lagged GNP escalator were discussed, only to be rejected by the provinces as too risky and financially inadequate.[8] Opting out proposals advanced by Quebec and Ontario were, in turn, dismissed by the federal government. In an attempt to break out of this continuing deadlock, a working committee was established in early 1975 and charged with developing health care cost-saving "targets" as the basis for renewed negotiations. This exercise came to an abrupt conclusion, however, when the federal government brought down its Budget of June 25, 1975, introducing arbitrary ceilings on the growth of its Medicare contributions and serving notice of its intent to terminate the Hospital Insurance Agreements in 1980 (the earliest date possible).

In the meantime, the provinces were becoming increasingly concerned about the future of the Revenue Guarantee. This program had been introduced in 1972 to protect the provinces from the revenue losses stemming from tax reform.[9] Although the Guarantee was scheduled to expire on December 31, 1976, the provinces argued that termination would force them into substantial tax increases, thereby making them the long-run losers under the 1972 reform. They suggested, therefore, that an extension of the program, or an unconditional transfer of tax room, was required. Adding to the emotion surrounding this complicated issue was the fact that, in early 1976, the federal government unilaterally changed the formula under which Guarantee entitlements were calculated; this action deprived the provinces of over $500 million in entitlements for 1976 alone.

A further area of concern was the threat of a permanent federal ceiling on the revenue equalization program, which in 1976-77 transferred $2.2 billion to the less wealthy provinces. An arbitrary feature had already slipped into this program because of unusual revenue developments in oil and natural gas. Various reforms were clearly required before the program could be renewed on April 1, 1977.

It was against this background of shared-cost ceilings and Revenue Guarantee retrenchment that the federal government chose to take a new

[8]Early federal health proposals culminated in the Lalonde-Turner formula, presented to the provinces in May 1973; it was formally rejected by the provinces, after careful evaluation, in the fall of 1974. The Faulkner formula for replacing the post-secondary arrangements was also presented to the provinces in May 1973, only to be rejected immediately.

[9]The consequences of the 1972 tax reform for federal and Ontario revenue are discussed in Ontario Tax Study 13, *The Equity and Revenue Effects in Ontario of Personal Income Tax Reform: 1972-1975* (Toronto: Ministry of Treasury, Economics and Intergovernmental Affairs, 1977).

initiative in respect of the shared-cost programs. At the Conference of First Ministers in June 1976, the Prime Minister indicated the five principles that would underlie a forthcoming federal proposal.[10]

- The federal government should continue to pay a substantial share of program costs;
- Federal payments should be calculated independently of provincial program expenditures;
- There should be greater equality, in per capita terms, in the federal contributions to the provinces;
- The arrangements for the mature programs should be placed on a more permanent footing; and,
- There should be provision for continuing federal participation in the development of policies of "national significance" in health and post-secondary education.

These principles were fairly broad and, in that sense, could be endorsed by most Premiers.

The principles were subsequently translated into the "Established Programs Financing Proposal" that was presented to the provinces at the Meeting of Ministers of Finance on July 6, 1976. In many respects, this EPF proposal was a logical extension of previous federal offers—the principle of GNP escalation was retained, per capita levelling was retained, and the package continued to consist of tax room plus cash (though the federal government left open the particular mix that was available). Two important departures, however, were the inclusion of post-secondary education contributions into the base, and the allowance of *independent* growth streams for the tax and cash components.[11] Also, the lag in the escalator and the time frame for levelling were modified. No mention was made of a Revenue Guarantee settlement.

In the following months, the provinces met to analyze this proposal, as well as alternatives suggested by a number of provinces.[12] It was subsequently agreed that the provinces would hold out for a transfer of 4 personal income tax points for the Revenue Guarantee, and that they would pursue an EPF agreement in which: half the package would be in tax room; the new tax room would consist of only personal income tax; the tax room would be equalized to the top-province yield; and upward levelling would take place in the first year. Considerable

[10] The Rt. Hon. Pierre Elliott Trudeau, "Established Programs Financing: A Proposal Regarding the Major Shared-Cost Programs in the Fields of Health and Post-Secondary Education", statement tabled at the Federal-Provincial Conference of First Ministers, June 14-15, 1976.

[11] Under the Lalonde-Turner proposal, the tax room was only a *mechanism* for delivering the GNP-determined quantum, so that the cash component would shrink if taxes grew rapidly (as under the PSE arrangement).

[12] Counter proposals were made by Quebec, Ontario, Saskatchewan and New Brunswick. For the Ontario proposal see, Hon. W. Darcy McKeough, *Reforming Fiscal Arrangements and Cost Sharing in Canada* (Toronto: Ministry of Treasury, Economics and Intergovernmental Affairs, 1976).

accommodations were made in reaching this first-ever consensus on financial arrangements, particularly by the Atlantic Provinces and Saskatchewan, who gave up their long-standing preference for continuing with some kind of cost sharing. The provincial proposal was relayed to the federal government by the Treasurer of Alberta, speaking on behalf of all provinces.[13]

The Meeting of Ministers of Finance on December 6 failed to find a compromise between the federal and consensus proposals, thus effectively passing the matter to the First Ministers for resolution. On December 14, the federal government suggested a number of changes and enrichments to its proposal. To this revised federal offer, the provinces reluctantly agreed, thus setting the stage for the Federal-Provincial Fiscal Arrangements and Established Programs Financing Act of 1977.

The New Arrangements

Under the new arrangements, the federal government will transfer to the provinces 13.5 points of personal income tax and one point of corporate income tax plus the approximate value of these points in a cash payment.[14] (The tax point transfer incorporates the 4.357 PIT and 1 CIT points that the provinces already have for post-secondary education; the *new* tax room provided, therefore, is 9.143 points of PIT). The tax points are equalized to the national average yield and the cash payments escalate in line with GNP experience. In addition, the federal government will pay, starting in 1977-78, $20 cash per capita in respect of such health-related services as nursing home intermediate care, lower level residential care for adults, the health aspects of home care, and those aspects of ambulatory health services not previously covered under the Hospital Insurance Agreements. This $20 per capita will grow in the same fashion as the other cash payments.

Despite the various provincial attempts to integrate equalization with the discussions on the shared-cost programs and the Revenue Guarantee, it remains separate from the EPF. The number of revenue bases used in the determination of "fiscal capacity" has been expanded to 29 to make the system more representative and to reduce the scope for provinces to influence their own entitlements. The old ceiling on oil and gas revenues has also been revised; henceforth, 50 per cent of all non-renewable natural resource revenues will be subject to equalization,

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[13]See Hon. M. Leitch, "Federal-Provincial Financial Arrangements: The Provincial Proposal", statement on behalf of all Provincial Ministers of Finance and Provincial Treasurers, December 6-7, 1976.

[14]The new package incorporates, as partial compensation for the Revenue Guarantee, 1 point of PIT as a tax transfer and the cash value of 1 PIT point in 1976-77 equalized at the national average. The Guarantee settlement was made contingent upon provinces agreeing to terminate their Hospital Insurance Agreements on March 31, 1977 rather than July 15, 1980. By accepting this, the provinces gave up the possibility of collecting the difference between the relatively more generous HIDS stream and the replacement EPF stream.

with the further stipulation that equalization in respect of natural resource revenues should not exceed one-third of total equalization.

The EPF itself is extremely difficult to evaluate in financial terms because of the many complexities and trade-offs involved. At the time of the December Conference, Ontario estimated that the federal government would contribute to all provinces $6.7 billion in 1977-78, whereas it would have contributed $7.1 billion under the Provincial Consensus Proposal. In this sense, the provinces would receive some $400 million less than they wanted in the first year. On the other hand, by extracting a compromise on the Revenue Guarantee, the provinces were successful in getting a better deal than the $6.1 billion that was on the table in June.

The situation with regard to Ontario is portrayed in Table 2. The table shows that, had the new arrangements applied to 1976-77, including the compromise on the Revenue Guarantee, Ontario would have lost almost $150 million. This loss would grow rather rapidly, because of the fast escalation of the full Revenue Guarantee compared to the partial compensation upon its termination. For 1977-78, therefore, the total loss to Ontario could well exceed $200 million.

Financial Implications of the New Fiscal Arrangements for Ontario, 1976-77 Table 2
($ million)

Under Old Arrangements		Under New Arrangements	
HIDS	1,025	13.5 pts. of PIT	991
PSE	592	1 pt. of CIT	70
Medicare	345	Cash Transfer	1,067
Revenue Guarantee	341	Revenue Guarantee	Nil
CAP and Nursing Home Benefits Agreement	120	$20 per capita	149
	2,423		2,277

More important than the numbers are the objectives that have been achieved. For its part, the federal government succeeded in constraining the growth of its program contributions to near-GNP, and will also be making equal per capita cash payments within five years. And, as an important psychological side effect in terms of the battle against inflation, it managed to reduce its 1977 expenditure growth rate by converting sizeable federal expenditures into revenue transfers to the provinces. The provinces gain the increased flexibility that they sought by having the federal contributions detached from provincial spending patterns. The growth of the overall federal contribution leaves them with considerable risk, but they can now adjust their delivery systems, without financial penalty, in order to provide lower cost services. A legislated commitment to national standards is retained, and, on the basis of federal figures, one can expect service level differences between

the richer and poorer provinces to decline.[15] The taxpayer position remains neutral and will, hopefully, improve over the longer term because of the improved cost-effectiveness of rationalized delivery systems.

One area of the EPF story remains. It was decided that, for the convenience of the taxpayers, the *new* 9.143 personal income tax points that were to be transferred should be transferred effective January 1, 1977, the start of the taxation year. But for the first three months of 1977, the provinces would continue to receive federal contributions under the old cost-sharing arrangements. Arguing from an accrual concept, the federal government maintained that the provinces were being overpaid by three months worth of tax, and that this sum would have to be recovered. Ontario and several other provinces replied that the new tax points would not actually flow to the provinces until March, so that, from a cash-on-hand viewpoint, the provinces would be overpaid by only one month. Moreover, it was noted that there was no overlap in respect of the points the provinces already had for post-secondary education, or in respect of the point that they received as compensation for the Revenue Guarantee. The amount of money involved in this issue was substantial. But, reflecting the spirit of compromise that had made the EPF possible, the federal and provincial governments agreed to split the difference, a rather complicated recovery formula being included in the Act for this purpose.

The Established Programs Financing Arrangements that have been described in this section took effect on April 1, 1977, and will continue until at least March 31, 1982. They stand as proof that substantial progress can indeed be made in terms of streamlining the relationships between the federal and provincial governments. The federal government achieved its basic objectives, while the provinces achieved the flexibility that they sought. In the process, the accountability of government has been enhanced, for the government that is doing the spending is now more responsible for raising the revenue to finance it. There is great scope for further disentanglement of responsibility in the Canadian Confederation. The success of the 1976 negotiations suggests that a satisfactory resolution can be reached through hard work, constructive criticism, and a willingness to compromise.

II The Implications of the Tax Transfer

This section explains how the tax transfer works and how it will be implemented in Ontario. It also looks at certain structural changes to the income tax system that are required to smooth the transfer of the

[15]The figures show that the Atlantic Provinces, Manitoba, and Saskatchewan all receive a larger percentage "financial difference" than Ontario. While Ontario still disputes the existence of gains on the three programs, due to underestimation of projected provincial spending, the distributional pattern of the alleged gains is significant.

tax room. Finally, the impact of the transfer on individual taxpayers is examined, since the tax transfer is intended to leave the taxpayer without any increase in combined federal and provincial tax.

Mechanics of the Tax Transfer

Under the Tax Collection Agreements, the base on which the provinces levy their personal income tax is the federal tax itself.[16] This base was known as 100 units or "points" of tax. Under the tax transfer, the federal government reduced its tax by 9.143 points, leaving the provinces to take up this vacated tax room by raising their rates.

This reduction in the provincial tax base has implications for the provincial rates, whether or not the vacated tax room is taken up. With a smaller tax base, the provinces need to raise their rates simply to maintain their old level of revenues. Since the old 100 point base was 110.063 per cent of the new base of 90.857 points, the revenue restoration factor for grossing up provincial rates is 1.10063. For example, Ontario would need to levy a rate of 30.5% (its pre-transfer rate) × 1.10063, or 33.57% against the new federal tax *just to maintain the level of revenue that would have been generated by the pre-transfer system.*

Similarly, it is necessary to gross-up the 9.143 points transferred to the provinces by the same factor of 1.10063 to reflect the fact that these points too are applied against a discounted tax base. This converts the 9.143 points vacated by the federal government to an equivalent provincial rate of 10.06%. Looking at Ontario again, the new Provincial tax rate becomes 33.57% + 10.06% for a total of 43.63%.

Table 3 presents in more detail the calculations required to arrive at this new Provincial tax rate. Table 4 shows the same calculation from the perspective of an individual taxpayer.

Under the terms of their Tax Collection Agreements, the provinces are required to round their tax rates to a half or full percentage point. Ontario has chosen to round up from an equivalent rate of 43.63% to an actual rate of 44% of federal tax. The equivalent rates for all the provinces that result from the tax transfer as well as the actual rates announced for 1977 are shown in Table 5.

Related Tax Structure Adjustments

Efficient and effective implementation of the tax transfer necessitates adjustments to certain features of the income tax structure. These adjustments include the rounding of the new federal marginal rates, a change to the dividend tax credit calculation, and a revised federal

[16]Except Quebec which does not have a tax collection agreement but levies a separate income tax directly on taxable income.

Determination of New Ontario Income Tax Rate

Table 3

Present Situation: federal tax (base for Ontario tax) 100.00
Ontario tax rate 30.5%

Step 1: Tax point transfer reduces base to which Ontario tax applies.

present base	100.000
point transfer	−9.143
new base	90.857

Step 2: Ontario has to gross up its present 30.5% rate to compensate for base reduction.

revenue restoration factor: $\frac{100.000}{90.857} = 1.10063$

converted present rate: 30.5% × 1.10063 = 33.569%

Step 3: New tax occupancy is also grossed up to compensate for base reduction.

9.143% × 1.10063 = 10.063%

Result:	converted present rate	33.569%
	new tax room	10.063%
	new Provincial rate	43.632%

Illustration of the Tax Point Transfer from a Taxpayer's Perspective

Table 4

Example: Consider the case of a taxpayer who pays $1,000 of federal income tax under the old system.

	Pre-Transfer	*Post-Transfer*
Federal Tax	$1,000	$ 908.57
Ontario Tax	$ 305	$ 396.43
Total Tax	$1,305	$1,305.00

Ontario Tax Rate:	Ontario Tax Rate:
$\frac{305}{1{,}000} = 30.5\%$	$\frac{396.43}{908.57} = 43.63\%$

Provincial Income Tax Rates

Table 5

(per cent)

	1976	Equivalent 1977	Actual 1977
Newfoundland	42.0	56.289	*
Prince Edward Island	36.0	49.686	50.0
Nova Scotia	38.5	52.437	52.5
New Brunswick	41.5	55.739	55.5
Quebec	n.a.	n.a.	n.a.
Ontario	30.5	43.632	44.0
Manitoba	42.5	56.840	*
Saskatchewan	40.0	54.088	58.5
Alberta	26.0	38.680	38.5
British Columbia	32.5	45.834	46.0

n.a. = not applicable.
*rate to be announced.

tax reduction scheme. Obviously, tax implications arise from these adjustments.

In implementing the 9.143 point tax transfer, the federal government did not scale down its marginal rate schedule uniformly by 9.143 per cent. Rather, it rounded to the nearest full percentage point for the sake of taxpayer convenience. The two exceptions are that the lowest marginal rate has been maintained at 6% despite the transfer, and that the 39% rate has been rounded to 36% rather than 35%. The old federal rate schedule and the adjusted federal rate schedule are shown in Table 6.

Federal Tax Rates — Table 6

Taxable Income	Pre-Transfer Rate	Pre-Transfer Rate Reduced by 9.143 Per Cent	Rounded Post-Transfer Rate
($)	(%)	(%)	(%)
0- 710	6	5.45	6
710- 1,419	18	16.35	16
1,419- 2,838	19	17.26	17
2,838- 4,257	20	18.17	18
4,257- 7,095	21	19.07	19
7,095- 9,933	23	20.89	21
9,933-12,771	25	22.71	23
12,771-15,609	27	24.53	25
15,609-19,866	31	28.16	28
19,866-34,056	35	31.79	32
34,056-55,341	39	35.43	36
55,341-85,140	43	39.06	39
85,140+	47	42.70	43

An adjustment is also required with respect to the dividend tax credit. Under the pre-transfer tax system, the dividend tax credit was defined as 80 per cent of the "gross-up" in dividends included in income for tax purposes. With the tax point transfer, maintaining this credit level would imply a larger credit for the same amount of dividend income compared to the current system. Consequently, the credit is reduced to 75 per cent of the gross-up, which is slightly more generous than that required to balance the tax transfer impact. Table 7 compares the dividend tax credit before and after the tax transfer.

A final adjustment occurs with respect to the tax reduction schemes. Both the federal and Ontario governments operate schemes which reduce tax payable. Under the pre-transfer system, the federal reduction was 8 per cent of federal tax payable, with a minimum reduction of $200 and a maximum reduction of $500.

Consistent with the federal decrease in basic tax of 9.143 per cent under the tax point transfer, one might expect that the reduction limits should be scaled down by the same percentage to a minimum

of $181.75 and a maximum of $454.28. But the tax reduction scheme needs amending rather than scaling down. This is necessary because part of the vacated tax room into which the Province is moving was sheltered from federal tax under the pre-transfer system by the federal tax reduction scheme. Since this part of the vacated tax room would no longer be sheltered after the transfer if the limits were reduced, it would mean higher total tax payable for taxpayers. To shelter taxfilers as effectively under the new system as under the pre-transfer system, the $200 minimum and $500 maximum have to be maintained and the reduction has to be raised to 8.8 per cent. Again, for simplicity, this reduction is rounded to 9 per cent, with the minimum and maximum maintained at $200 and $500, respectively.

To complement the federal alterations to the tax reduction scheme and ensure that no filers pay Ontario income tax where no federal income tax is paid, the Ontario tax reduction scheme will be enriched to include all filers with up to $1,680 in taxable income (up to $200 in federal tax payable). Under the pre-transfer system, Ontario's tax reduction scheme applied to all filers with up to $1,580 in taxable income. Ontario's complementary action, therefore, will save up to $88 in Ontario tax payable for filers with taxable income between $1,580 and $1,680.

Impact of Tax Transfer on the Dividend Tax Credit (dollars) Table 7

Example:

Consider the case of a taxpayer with $750 in dividends from Canadian corporations. This figure is then grossed up by one-third (= $250) to yield taxable dividends of $1,000.

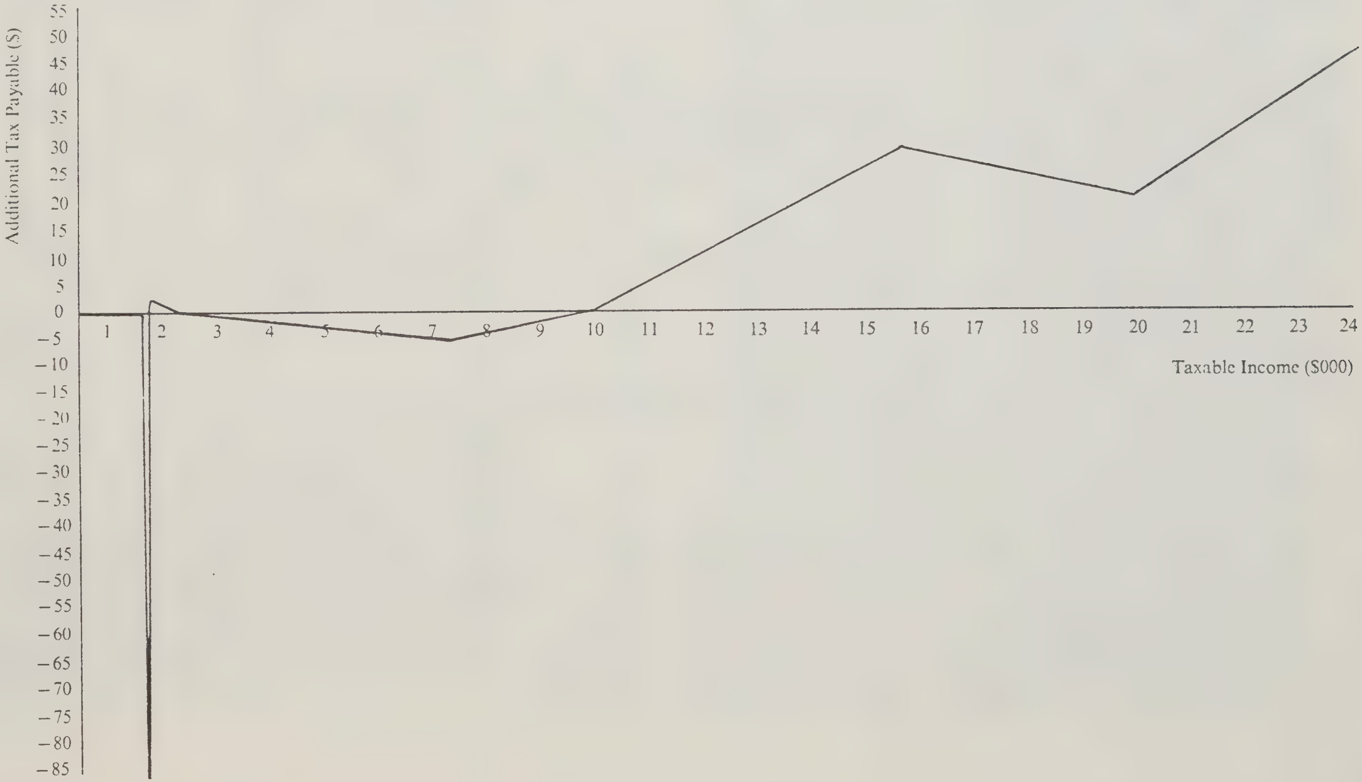
	Pre-Transfer	Post-Transfer
Taxable Dividends	1,000.00	1,000.00
Federal Dividend Tax Credit	200.00	187.50
Ontario Dividend Tax Credit	61.00	82.50
Total Dividend Tax Credit	261.00	270.00

Note: The impact of the transfer on the dividend tax credit is a benefit to the taxpayer of $9 per $1,000 of taxable dividends.

Impact on Taxpayers

The clear intent of the tax point transfer contained in the new fiscal arrangements was that the impact on taxpayers should be as neutral as possible. More of taxpayers' tax dollars would go to the provinces and less would go to the federal government, but the total

Impact of Tax Transfer on Tax Payable



tax burden would remain the same. The transfer achieved this goal, except for slight variations in the magnitude of actual tax payable because of the rounding of tax rates and the changes to the tax reduction schemes and to the dividend tax credit. Chart 1 illustrates the size of the variations involved for the majority of taxpayers.

A general review of the actual impact of the tax point transfer on filers indicates the following features.

- Taxfilers with taxable income below $1,580 will continue to pay no federal or Ontario income tax.
- In addition, taxpayers with taxable income between $1,580 and $1,680 will now pay no tax at all (tax saving of up to $86).
- Taxpayers with taxable income between $1,680 and $2,305 will pay slightly more total tax after the tax point transfer— but in no case exceeding $2.
- Taxpayers with taxable income between $2,305 and $9,815 will pay slightly less total tax after the tax point transfer.
- Taxpayers with taxable income over $9,815 will pay more total tax. The additional tax payable for higher income taxpayers generally increases as income increases, which in turn improves the progressivity of the income tax.

Table 8 indicates the impact of the tax transfer on representative taxpayers. This table shows the very minor effect for low-income taxpayers and the modest increases for all higher income taxpayers. Even for taxpayers with $25,000 income, the maximum increase is less than one-half of one per cent of total tax payable.

Impact of the Tax Point Transfer on Representative Taxpayers

(dollars)

Gross	Pre-Transfer			Post-Transfer			Change in
Income	Federal Tax	Ontario Tax	Total Tax	Federal Tax	Ontario Tax	Total Tax	Total Tax
Single Taxpayer							
5,000	143.32	104.71	248.03	111.07	136.87	247.95	−0.08
8,000	728.79	283.28	1,012.07	638.29	368.85	1,007.13	−4.94
10,000	1,139.27	408.48	1,547.75	1,009.60	532.22	1,541.82	−5.93
15,000	2,325.81	771.06	3,096.86	2,092.61	1,011.81	3,104.41	7.55
20,000	3,613.71	1,198.02	4,811.73	3,260.98	1,576.74	4,837.72	25.99
25,000	5,124.33	1,698.83	6,823.15	4,618.42	2,233.08	6,851.50	28.35
Married Taxpayer							
5,000	0.00	0.00	0.00	0.00	0.00	0.00	0.00
8,000	320.84	158.85	479.70	269.76	206.69	476.45	−3.25
10,000	719.68	280.50	1,000.18	630.04	365.22	995.26	−4.92
15,000	1,830.55	619.32	2,449.87	1,641.87	810.42	2,452.29	2.42
20,000	3,062.66	1,015.34	4,077.99	2,766.45	1,337.62	4,104.07	26.08
25,000	4,483.55	1,486.39	5,969.94	4,038.93	1,952.89	5,991.82	21.88
Married Taxpayer With Two Children							
5,000	0.00	0.00	0.00	0.00	0.00	0.00	0.00
8,000	156.60	108.76	265.37	122.96	142.10	265.06	−0.31
10,000	540.88	225.97	766.85	468.28	294.04	762.32	−4.53
15,000	1,628.81	557.79	2,186.59	1,456.56	728.89	2,185.45	−1.14
20,000	2,849.03	944.52	3,793.55	2,570.80	1,243.02	3,813.82	20.27
25,000	4,226.89	1,401.30	5,628.19	3,808.80	1,841.62	5,650.42	22.23
Single Pensioner							
5,000	0.00	0.00	0.00	0.00	0.00	0.00	0.00
8,000	314.40	156.89	471.29	263.96	204.14	468.10	−3.19
10,000	724.13	281.86	1,005.99	634.07	366.99	1,001.06	−4.93
15,000	1,841.25	622.58	2,463.83	1,651.71	814.75	2,466.46	2.63
20,000	3,073.29	1,018.86	4,092.15	2,776.18	1,342.33	4,118.51	26.36
25,000	4,497.33	1,490.96	5,988.29	4,051.39	1,958.92	6,010.31	22.02
Married Pensioner							
5,000	0.00	0.00	0.00	0.00	0.00	0.00	0.00
8,000	0.00	0.00	0.00	0.00	0.00	0.00	0.00
10,000	304.40	153.84	458.24	254.96	200.18	455.14	−3.10
15,000	1,364.95	477.31	1,842.26	1,215.65	622.89	1,838.54	−3.72
20,000	2,564.07	850.04	3,414.11	2,309.81	1,116.83	3,426.64	12.53
25,000	3,899.71	1,292.84	5,192.54	3,516.49	1,700.28	5,216.78	24.24

Appendix

Calculating EPF Entitlements

In the interest of equity, the EPF calculations necessarily became complex. As Ontario understands them, the basic calculations, including the Revenue Guarantee settlement, are as follows:

(a) For each province, determine the per capita federal contribution in 1975-76 and escalate this amount by the three-year moving average GNE index to derive values for 1976-77 and all subsequent years.

(b) Determine the 1975-76 national average federal contribution per capita, and escalate it in similar fashion for 1976-77 and all subsequent years.

(c) Translate 50% of the 1976-77 value of (b) into equalized tax points, on the basis of the yield in the two highest yielding provinces, resulting in a transfer of 8.143 *new* tax points in addition to the 4.357 PIT plus 1 CIT points that provinces already have. Add one equalized tax point for the Revenue Guarantee. Allow the tax room to grow at its natural elasticity into 1977-78 and all subsequent years.

(d) Translate the other 50% of the 1976-77 value of (b) into cash per capita. Add to this amount the cash equivalent of one 1976 equalized PIT point per capita at the national average yield. Escalate this total by the GNE index to get the basic cash entitlement for 1977-78 and all subsequent years.

(e) Since some provinces receive less under a tax-cash split than they would under an all-cash arrangement, make a transitional payment to a province if it receives less under (c) and (d) (excluding the Guarantee components) than it would have received under the all-cash entitlement of (b).

(f) Level by gradually eliminating the difference between (a) and (b). For provinces in which (b) exceeds (a), the cash contribution is raised to the national average over 3 years; for provinces in which (a) exceeds (b), the cash contribution is lowered to the national average over 5 years.

(g) Starting in 1977-78, pay to each province \$20 per capita in respect of nursing home care, residential care for adults, converted mental hospitals, the health aspects of home care, and those aspects of ambulatory health services not covered under HIDS. Escalate this \$20 beyond 1977-78 in the same way as other cash payments.

The following table displays the detailed calculation for Ontario and Newfoundland.

Computing EPF Entitlements[1]

($ per capita)

Table 1

	Nfld.	Ont.	Natl. Avg.
Base Contribution, 1975-76	184.80	207.70	207.60
Escalated by 1.1381, 1976-77	210.30	236.40	236.30[2]
Escalated by 1.1309, 1977-78	237.90	267.30	267.20
Equalized Tax Room[3], 1976-77	98.10	118.70	
Equalized Tax Room, 1977-78	115.40	135.30	
Basic Cash, 1976-77	118.20	118.20	
Escalated by 1.1309, 1977-78	133.60	133.60	
Tax Plus Cash, 1977-78	249.00	268.90	
Transitional Payment[4]	18.20	0.00	
	267.20	268.90[5]	
Levelling, 1977-78	– 19.50[6]	+ .08[7]	
Total 1977-78	247.70	268.98	

[1]Excluding Revenue Guarantee element and $20 per capita.

[2]This figure is the basis for the 50-50 split between tax and cash in the two provinces with the highest per capita tax yields.

[3]Value of 12.5 PIT points and 1 CIT point equalized at the national average.

[4]Amount necessary to bring tax plus cash up to the all-cash national average reference point of $267.20 per capita.

[5]Note that Ontario receives a "fiscal dividend" (or negative transition) of $1.70 because the value of its tax room exceeds the value of the basic cash contribution.

[6]Newfoundland is levelled up in 3 steps; in the first year subtract from the cash payments .66 × ($267.20 – $237.90) = $19.50. The actual cash per capita is thus $133.60 + $18.20 – $19.50 = $132.30. Check: $132.30 + $115.40 = $247.70.

[7]Ontario is levelled down in 5 steps; in the first year we add to the cash payments .8 × ($267.30 – $267.20) = $.08. The actual cash per capita is thus $133.60 + $.08 = $133.68. Check: $133.68 + $135.30 = $268.98.

Background to the Federal-Provincial Conference of Finance Ministers

Ottawa, December 6-7, 1976

Finance Finances

The December 6-7 meeting is the third in a series this year devoted to the renegotiation of the major financial arrangements between the federal and provincial governments.

The programs in brief:

FISCAL ARRANGEMENTS

Equalization

The federal government makes annual payments to provinces that are below the national average per capita in their capacity to raise revenues from their taxpayers. The purpose of the program is to make it possible for such provinces to provide reasonable standards of public services without having to resort to levels of taxation that are above the national average. The present program was introduced in 1967, and renewed in 1972. Payments this year total $2.2 billion. The program expires on March 31, 1977.

Revenue Guarantee

For a five-year period the federal government guarantees provincial income tax revenues against loss as a result of 1972 tax reform and most subsequent tax changes. Payments in the last completed year, 1975-76, totalled $460 million. The program ends with the 1976-77 taxation year.

Revenue Stabilization

Since 1967, the federal government has provided protection to each province in the event of a year-over-year loss in revenue resulting from a downturn in economic activity. No payment has been necessary to date as provincial revenues have risen steadily. The program expires on March 31, 1977.

Tax Collection Agreements

The federal government collects free of charge personal and corporate income taxes levied by provinces which adopt a uniform tax system. Agreements have been in force since 1962 and are continuous.

HARED-COST PROGRAMS

Post-secondary Education

Since 1967, the federal government has paid half the operating costs of post-secondary education in Canada. The contribution in the current fiscal year is $1.6 billion. Payments are made under the Fiscal Arrangements Act, expiring March 31, 1977.

Medicare

Under the Medical Care Act, in effect since 1968, the federal government pays half the national average per capita cost of medical services, multiplied by the number of insured persons in the province. Cost in the current fiscal year is $960 million. The program has no termination date.

Hospital Insurance

Under the Hospital Insurance and Diagnostic Services Act, in effect since 1958, the federal government pays the provinces approximately half the costs of most in-patient hospital services and a number of out-patient services. Federal contributions in the current fiscal year total $2.7 billion. Notice has been given for termination of current agreements July 15, 1980 in anticipation of new arrangements before that date.

THER PROGRAMS

Contracting Out

Under the Established Programs (Interim Arrangements) Act, Quebec receives its share of the federal payments toward certain shared-cost programs in the form of personal income tax points and the balance in the form of adjustment payments.

Reciprocal Taxation

Six provinces will begin paying federal consumption taxes on their purchases and the federal government will make payments in lieu of provincial taxes and fees. The net cost to the federal government will be $25 million on a full-year basis.

Sharing of Tax on Undistributed Income of Corporations

The provinces share an elective tax with the federal government on the "1971 undistributed income of corporations". Initiated with the 1972 tax reform, it will have resulted in cumulative payments of $50 million by March 31, 1977.

FISCAL ARRANGEMENTS

Equalization

Equalization is a powerful tool used by the federal government to alleviate regional income disparity in Canada. The program has enabled all provinces to provide services to the public at national standards without having to resort to excessive rates of taxation. Payments in the current year amount to $2.2 billion and go to seven provinces - the four Atlantic Provinces, Quebec, Manitoba and Saskatchewan.

Equalization payments are commonly and erroneously described as payments from wealthy provinces to poorer ones. In fact, the program is financed from the general revenues of the Government of Canada which are drawn from taxpayers in all parts of the country according to their ability to pay.

Calculations of equalization are based at present on what is known as a "representative tax system" considered typical of systems actually in effect in the provinces. In calculating equalization, this system is "applied" to all provinces and the resulting revenue yields are compared on a per capita basis. Since some provinces have richer tax bases than others, the per capita yield of the system varies between provinces. Those which have a per capita yield below the "national average" (i.e., the weighted average of all provinces) are entitled to equalization to bring them up to the national average. The amount of a qualifying province's entitlement is equal to its shortfall from the national average yield of the representative tax system multiplied by its population.

Equalization payments in the current fiscal year are expected to be as follows:

	($ millions)
Newfoundland	235
Prince Edward Island	57
Nova Scotia	300
New Brunswick	232
Quebec	1,142
Manitoba	165
Saskatchewan	86
	2,217

On April 1, 1976 the Minister of Finance indicated that the equalization program would be renewed but that he hoped a number of problems in the present program could be dealt with. These included a danger that the program would grow more rapidly than the capacity of federal taxpayers to finance it, arbitrary elements in the formula, and inherent possibilities of provinces' taking action which could influence their own equalization.

To a considerable extent the problems which have arisen in equalization relate to the treatment of natural resource revenues, particularly oil and gas. The impact on provincial revenues of the dramatic increases in oil and gas prices in 1973 and 1974 threatened to add enormously to the cost of equalization - to the point where even Ontario might qualify for payments. As a result, the legislation was amended, effective with 1974-75, to limit the amount of equalization paid on what were considered to be windfall revenues from higher oil and gas prices. Two-thirds of the increased revenues were excluded from equalization for the balance of the 1972 arrangements.

Revenue Guarantee

The revenue guarantee program was proposed at the time of the 1972 tax reform to encourage provinces to adopt the federal reforms for their own tax systems. Because the yield of the new system was difficult to estimate, the federal government undertook to pay to the provinces any shortfall of revenue if they adopted the reformed system for both personal and corporate income taxes. The guarantee was initially proposed for three years and later extended to five years. Once provinces had some experience with the new system, they were expected to adjust their rates to compensate for any differences.

Since 1972 the federal government has extended the terms of the guarantee to cover virtually all changes in federal income taxes affecting provincial revenues, with the major exception of the indexation of personal income taxes. By the 1976 tax year it is expected that personal income tax changes since tax reform will add as much to the cost of the guarantee as the original tax reform changes.

Revenue Stabilization

The revenue stabilization program provides each province with a guarantee against year-to-year losses in the event of a downturn in economic activity. It protects essential public services against adverse economic conditions.

Since its inception in 1972 no payments have been necessary because provincial revenues have continued to rise each year. However, the program has provided potential protection and has

proved valuable to provinces when they raise funds in foreign capital markets. The program has become an integral part of ongoing fiscal arrangements and will be renewed in 1977.

The Minister of Finance indicated at the April, 1976 meeting that it may be necessary to modify the program to limit federal liability under this program in respect of resource revenues. While the program should continue, it was not intended to cover losses resulting from substantial and foreseeable declines in non-renewable resource production.

Tax Collection Agreements

Since 1962, personal and corporate income taxes in most provinces have been collected by the federal government under uniform federal rules. The current tax collection agreements cover provincial personal income taxation in all provinces but Quebec, and provincial corporate income taxation in all but Ontario and Quebec. The agreements remain effective unless terminated by either party. This may be done on December 31 of any year, with three months' notice required on the part of a province or notice of one year by Canada.

The federal government collects these taxes free of charge provided that provinces express their personal tax rate as a percentage of the federal basic tax on individuals, and their corporate income tax rate as a percentage of the taxable income of corporations as determined under the federal income tax law. The tax collection system allows agreeing provinces to set their own tax rates and at the same time saves their taxpayers the trouble and expense of making different calculations of taxable income, exemptions, depreciation and so on.

With the tax reform of 1972, the federal government offered to administer provincial tax credit plans in order to open up greater scope for provinces to change their own systems to meet their own policy requirements. Since then, personal income tax credit systems have been introduced in Ontario (property tax, sales tax, pensioners credits and a credit for political contributions), Manitoba (property tax and cost of living credits) and Alberta (property tax credit for renters).

In addition, the federal government administers, on behalf of Ontario, Saskatchewan, and Alberta, tax cuts which complement the federal tax cut of 8 per cent with a minimum of $200 and a maximum of $500. The government administers Saskatchewan, Alberta, and British Columbia credits to resource corporations designed to offset the effect on provincial corporate taxes of the disallowance of provincial royalties as an expense. In Alberta, the credit to resource corporations offsets the effects on both federal and provincial taxes.

ESTABLISHED PROGRAMS FINANCING

The federal government's "established programs" proposals are designed to replace current arrangements for medicare, hospital insurance and post-secondary education. Contributions under these programs, currently total over $5 billion, based on a 50-50 sharing of eligible program costs between federal and provincial governments. For post-secondary education in all provinces and for hospital insurance in Quebec, part of the contribution is made by means of a tax transfer.

Provincial governments have long been concerned about federal interference in these provincial programs; the federal government has defined the costs eligible for sharing and it has audited provincial accounts. Both levels of government have been concerned with escalation of program costs, recognizing that the existing "open-ended" sharing formula tends to discourage efficient delivery of services. For example, if a province spends 50 cents under the rules, it automatically receives a matching federal 50 cents. This has given rise to the observation that the provinces are spending "50-cent dollars". Similarly, if a province finds a way to save 50 cents, it automatically loses 50 cents of federal sharing. In a purely provincial program, any saving managed by the government is reflected fully in the provincial budget. A formula that "untied" the federal contribution from actual spending by the provinces would provide more incentive to save and less to spend.

Since 1970 the two levels of government have attempted to reach agreement on a number of proposals to limit program growth and to change the way in which the federal share is paid, in order to decrease federal interference while ensuring that the delivery of services is improved. Table 1 compares the growth of federal contributions to these programs with the gross national product for the years 1972-73 through 1976-77.

Medicare and Hospital Insurance

The June 23, 1975 federal budget announced the government's intention to impose temporary ceilings on the federal contribution to medicare. Subsequent legislation passed by Parliament provided that the per capita medicare contributions to provinces would be limited to 13 per cent in 1976-77, 10.5 per cent in 1977-78, and in subsequent years by a percentage established annually by Governor-in-Council. The same budget gave notice of the federal government's intention to terminate the present hospital insurance agreements in 1980, anticipating that the interim period would be used by the two levels of government to co-operate in developing more flexible and less costly arrangements for the financing of hospital care in Canada.

Post-secondary Education

The present arrangements for federal financing of post-secondary operating costs came into effect in 1967 for the period 1967-72. They were later extended to 1974, and again to 1977. Since 1972, the total increase in the federal share in any given year has been limited to 15 per cent of the preceding year. The greater part of the share is paid in the form of a federal tax transfer of 4.357 points of personal income tax and 1 point of corporate income tax. The balance is paid in cash.

Current Negotiations

On June 14, 1976 the Prime Minister made a proposal to replace the present cost-sharing arrangements for medicare, hospital insurance and post-secondary education under which federal contributions would no longer be tied to provincial expenditures.

He said the proposal had these objectives:

- to maintain across Canada the standards of service to the public under these major programs, and to facilitate their improvement;

- to put programs on a more stable footing, so that both levels of government are better able to plan their expenditures;

- to give the provinces flexibility in the use of their own funds which they have been spending in these fields;

- to bring about greater equality among the provinces with regard to the amount of federal funds they receive under the programs; and

- to provide for continuing joint policy discussions relating to the health and post-secondary education fields.

The essential financial elements of the proposal:

The Formula: The federal government would commit itself to long-term financial assistance in the areas of post-secondary education, medicare and hospital insurance in exchange for commitments from the provinces to satisfy certain broad program conditions. To help preserve a federal presence and maintain national standards, a substantial part of the federal contribution would be paid in cash. To increase provincial fiscal flexibility, a substantial portion of the federal contribution would be in the form of a tax transfer equalized to the national average. The cash portion would be related to the national average federal contribution per capita under the three programs embraced by the proposal in a base

year and escalated in relation to the growth of the economy. The tax portion would be related to the same base year contribution and would grow with the natural increase of tax yields.

Base Year: The base year would be the last completed fiscal year, 1975-76.

Escalator: The escalator for determining federal contributions would be a three-year moving average of nominal (current prices) Gross National Expenditure per capita. This escalator would provide for reasonably stable growth of federal contributions more or less in line with growth of the Canadian economy.

Levelling Adjustments: The current aggregate federal contributions for post-secondary education, medicare, and hospital insurance vary widely among the provinces on a per capita basis. To achieve a transition from the present cost-sharing arrangements to equal per capita grants, the current per capita differences would be eliminated gradually over a five-year period.

Transition Adjustments: Since the value of any tax transfer would vary from province to province, the sum of the tax and cash transfer would not in all provinces initially equal what the federal contribution under the formula would be if the transfer were all in cash. Hence, the tax transfer in the low-yield provinces would be "topped up" with cash for a transitional period. Since the tax portion can be expected to grow more quickly than the cash portion, these transition adjustments would eventually disappear. At that point the provinces would receive a total transfer, i.e., cash plus tax, in excess of what the federal contribution under the formula would be if the transfer were all in cash.

A number of alternative mixes of tax transfers and cash are before the provinces for study. The projected contributions under each are set out in Tables 3, 4, 5, 6 and 7; the projected differences between the alternatives and the current arrangements are shown in Tables 3A, 4A, 5A, 6A and 7A. The first all-cash alternative is only a hypothetical reference point against which to compare the other alternatives. The calculations briefly:

1. All cash
2. Two-thirds cash, 8 points personal income tax, one point corporate tax
3. Half cash, plus half federal alcohol taxes, half tobacco taxes, 8½ points personal income tax, one point corporate tax
4. Half cash, 12½ points personal income tax, one point corporate income tax
5. One third cash, 12 points personal income tax, one point corporate income tax, half alcohol taxes, half tobacco taxes.

All income tax transfers include the existing 4.357 points personal and one point corporate under the post-secondary education financing formula.

To give effect to the tax transfer agreed upon, the federal rate schedule will be reduced in 1977 by the equivalent of the tax transfer and provincial rates will be raised by the same amount.

OTHER PROGRAMS

Contracting-Out

In the mid-1960s, arrangements were proposed to allow any province to assume administrative and financial responsibility for certain joint programs in return for an abatement of personal income tax points. The offer was taken up only by Quebec. In hospital insurance 16 income tax points are abated, in the special welfare program, including the Canada Assistance Plan, 5 points are abated and 3 points are abated for youth allowances, for a total of 24 points. In 1973, the youth allowance program came to an end and the value of 3 points has been subtracted from other payments owing to Quebec.

The total contribution to Quebec under these programs is the same as if it had been under the cash payment arrangement with other provinces.

With the introduction of a new financing formula for the established programs, the number of tax points abated to Quebec for purposes of computing federal income tax liabilities will be reduced by the number of tax points transferred to the provinces in respect of the established programs.

Reciprocal Taxation

The federal government and six provinces (Ontario, Quebec, New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland) have approved a federal-provincial system of reciprocal taxation on consumption taxes. The federal government will enter into

individual bilateral agreements with these provinces. Under the system, the provinces will pay federal sales taxes on their purchases of goods and services and the federal government will make payments in lieu of provincial sales taxes, gasoline taxes and motor vehicle license fees on its purchase of goods and services, and for federal vehicles operating in these provinces.

Under the existing sales tax arrangements generally, the provinces do not bear the indirect federal sales tax and the federal government does not pay the direct sales taxes of the provinces. The sales taxes of the other level of government are normally applicable to both federal and provincial Crown corporations.

The reciprocal taxation system is expected to take effect on October 1, 1977 and the initial agreement, with provisions for renewal, will terminate on March 31, 1981. On a full fiscal-year basis, the six provinces will pay an estimated $75 million in federal sales taxes while the federal government will pay $100 million in provincial taxes and motor vehicle license fees. This will mean a net cost to the federal treasury of $25 million.

This new arrangement has been developed over the past several years, in co-operation with the provinces, in response to many federal-provincial problems which have arisen with respect to the intergovernmental application of sales taxes. The arrangement will help establish the principle that the government sector should pay the same taxes on its economic activity as the private sector.

Sharing of Undistributed Income of Corporations

Provinces receive a share of the elective tax on "1971 undistributed income of corporations." The tax was introduced as part of tax reform and relates to retained profits earned before tax reform. By March 31, 1977, close to $50 million will have been paid to the provinces under this program.

Payments will decline and eventually disappear as the pre-1972 retained profits are paid out. But the disbursements may continue over a considerable period since they are influenced by the liquidity requirements of corporations. For this reason no time limit was put on this program in the present Act nor will there be in future legislation.

For further information:

Information Division,
Department of Finance,
(613) 992-1573.

TABLE 1

FEDERAL SHARED-COST PROGRAM CONTRIBUTIONS AND GROSS NATIONAL PRODUCT
Current Arrangements

	Hospital Insurance	Medicare	Post-Secondary Education	Three-Program Total	GNP
			(Millions of dollars)		
1972-73	1,339	638	1,012	2,989	104,669
1973-74	1,553	685	1,161	3,399	122,582
1974-75	1,942	730	1,330	4,002	144,616
1975-76	2,355	837	1,530	4,722	161,132
1976-77	2,692	959	1,760	5,411	185,575
Projection					
1981-82	4,482	1,680	2,524	8,686	300,950
			(Annual rates of increases %)		
1972-73	11.0	9.1	8.8	9.8	11.2
1973-74	16.0	7.4	14.7	13.7	17.1
1974-75	25.0	6.6	14.6	17.7	18.0
1975-76	21.3	14.7	15.0	18.0	11.4
1976-77	14.3	14.6	15.0	14.6	15.2
Average Annual Compound Growth Rate					
1972-73 to 1976-77	19.0	10.7	14.8	16.0	15.4
1977-78 to 1981-82	10.9	11.9	7.9	10.2	9.6

Sources: - Health and Welfare Canada and Department of the Secretary of State

- GNP: 1972 to 1975: Statistics Canada (revised National Accounts basis)
  1976 to 1981: Department of Finance.

TABLE 2

Financing Alternatives Established Programs

Calculation	% Cash	% Alcohol	% Tobacco	Personal Income Tax*	Corporate Income Tax*
2	66	0	0	8	1
3	50	50	50	8½	1
4	50	0	0	12½	1
5	33	50	50	12	1

* Includes the 4.357 points Personal Income Tax and one point Corporate Income Tax under the Post-Secondary Education Arrangements.

ESTABLISHED PROGRAMS FINANCING
Projection of payments to provinces on
all-cash basis (Calculation 1)

	Nfld.	P.E.I.	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta	B.C.	Total
(Millions of Dollars)											
1977-78	137.1	28.5	214.2	170.0	1,665.2	2,257.7	263.2	234.4	502.3	634.5	6,107.1
1978-79	158.1	33.2	243.3	196.9	1,868.1	2,550.8	298.4	270.2	570.3	737.6	6,926.8
1979-80	182.1	38.8	276.2	227.6	2,093.0	2,878.4	338.2	310.5	646.5	856.3	7,847.5
1980-81	206.3	44.4	309.1	258.8	2,309.5	3,197.8	377.3	351.5	721.9	978.6	8,755.2
1981-82	231.6	50.5	342.5	291.6	2,525.6	3,522.0	417.1	394.2	798.7	1,108.1	9,682.0
(Per Capita in Dollars)											
1977-78	243.90	233.41	255.27	243.52	265.54	267.28	254.83	247.53	269.76	248.83	261.76
1978-79	278.38	269.61	287.89	278.06	296.47	297.93	287.52	281.41	300.00	282.50	293.30
1979-80	317.18	310.67	324.23	316.94	330.60	331.68	323.96	319.42	333.22	320.23	328.24
1980-81	355.61	352.04	359.47	355.47	362.96	363.56	359.32	356.84	364.40	357.28	361.66
1981-82	394.62	394.62	394.62	394.62	394.62	394.62	394.62	394.62	394.62	394.62	394.62
(Annual Growth Rates in Percentages)											
1977-78	16.9	19.3	15.4	17.4	13.7	14.5	15.0	16.7	15.0	17.9	15.0
1978-79	15.4	16.5	13.6	15.8	12.2	13.0	13.4	15.2	13.5	16.2	13.4
1979-80	15.1	17.1	13.6	15.6	12.0	12.8	13.3	14.9	13.4	16.1	13.3
1980-81	13.3	14.2	11.9	13.7	10.3	11.1	11.6	13.2	11.7	14.3	11.6
1981-82	12.3	13.9	10.8	12.7	9.4	10.1	10.6	12.2	10.6	13.2	10.6

TABLE 3A
ESTABLISHED PROGRAMS FINANCING
Projection of difference between Calculation 1 (All-cash basis) and payments under continuation of existing arrangements

	Nfld.	P.E.I.	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta	B.C.	Total
(Millions of Dollars)											
1977-78	3.8	1.8	5.8	8.5	39.6	63.2	7.8	11.4	31.3	33.8	207.0
1978-79	8.6	3.5	12.7	16.6	57.5	97.7	14.5	23.9	44.9	64.2	344.0
1979-80	16.9	6.0	22.5	27.9	108.1	162.2	26.7	38.7	61.9	103.5	574.3
1980-81	24.8	8.2	31.8	38.8	146.5	211.7	36.7	53.1	75.1	141.5	768.2
1981-82	34.2	11.2	42.1	51.8	188.3	271.0	48.5	69.5	91.1	188.0	995.8
(Per Capita in Dollars)											
1977-78	6.71	14.56	6.88	12.14	6.31	7.48	7.59	12.05	16.81	13.26	8.87
1978-79	15.18	28.15	14.99	23.40	9.12	11.42	14.01	24.85	23.62	24.59	14.57
1979-80	29.37	48.27	26.46	38.80	17.08	18.69	25.59	39.80	31.88	38.70	24.02
1980-81	42.67	64.74	37.03	53.28	23.03	24.07	34.94	53.89	37.90	51.66	31.73
1981-82	58.33	87.59	48.54	70.13	29.42	30.36	45.90	69.60	45.02	66.95	40.59

TABLE 4
ESTABLISHED PROGRAMS FINANCING
Projection of payments to provinces on basis of
two thirds cash, 8 points p.i.t., one point corporate tax
(Calculation 2)

	Nfld.	P.E.I.	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta	B.C.	Total
(Millions of Dollars)											
1977-78	137.1	28.5	214.2	170.0	1,665.2	2,267.5	263.2	234.4	502.3	634.5	6,116.8
1978-79	158.1	33.2	243.3	196.9	1,868.1	2,553.8	298.4	270.2	570.3	737.6	6,929.7
1979-80	182.1	38.8	276.2	227.6	2,093.0	2,878.4	338.2	310.5	646.5	856.3	7,847.5
1980-81	206.3	44.4	309.1	258.8	2,309.5	3,206.4	377.3	351.5	721.9	978.6	8,763.7
1981-82	231.6	50.5	342.5	291.6	2,525.6	3,545.3	417.1	394.2	798.7	1,108.1	9,705.3
(Per Capita in Dollars)											
1977-78	243.90	233.41	255.27	243.52	265.54	268.44	254.83	247.53	269.76	248.83	262.18
1978-79	278.38	269.61	287.89	278.06	296.47	298.27	287.52	281.41	300.00	282.50	293.42
1979-80	317.18	310.67	324.23	316.94	330.60	331.68	323.96	319.42	333.22	320.23	328.24
1980-81	355.61	352.04	359.47	355.47	362.96	364.53	359.32	356.84	364.40	357.28	362.02
1981-82	394.62	394.62	394.62	394.62	394.62	397.23	394.62	394.62	394.62	394.62	395.57
(Annual Growth Rates in Percentages)											
1977-78	16.9	19.3	15.4	17.4	13.7	14.8	15.0	16.7	15.0	17.9	15.1
1978-79	15.4	16.5	13.6	15.8	12.2	12.6	13.4	15.2	13.5	16.2	13.3
1979-80	15.1	17.1	13.6	15.6	12.0	12.7	13.3	14.9	13.4	16.1	13.2
1980-81	13.3	14.2	11.9	13.7	10.3	11.4	11.6	13.2	11.7	14.3	11.7
1981-82	12.3	13.9	10.8	12.7	9.4	10.6	10.6	12.2	10.6	13.2	10.7

TABLE 4A
ESTABLISHED PROGRAMS FINANCING
Projection of difference between Calculation 2 (Two thirds cash, 8 points p.i.t., one point corporate tax) and payments under continuation of existing arrangements

	Nfld.	P.E.I.	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta	B.C.	Total
					(Millions of Dollars)						
1977-78	3.8	1.8	5.8	8.5	39.6	73.0	7.8	11.4	31.3	33.8	216.7
1978-79	8.6	3.5	12.7	16.6	57.5	100.7	14.5	23.9	44.9	64.2	346.9
1979-80	16.9	6.0	22.5	27.9	108.1	162.2	26.7	38.7	61.9	103.5	574.3
1980-81	24.8	8.2	31.8	38.8	146.5	220.3	36.7	53.1	75.1	141.5	776.7
1981-82	34.2	11.2	42.1	51.8	188.3	294.3	48.5	69.5	91.1	188.0	1,019.1
					(Per Capita in Dollars)						
1977-78	6.71	14.56	6.88	12.14	6.31	8.64	7.59	12.05	16.81	13.26	9.29
1978-79	15.18	28.15	14.99	23.40	9.12	11.76	14.01	24.85	23.62	24.59	14.69
1979-80	29.37	48.27	26.46	38.80	17.08	18.69	25.59	39.80	31.88	38.70	24.02
1980-81	42.67	64.74	37.03	53.28	23.03	25.04	34.94	53.89	37.90	51.66	32.08
1981-82	58.33	87.59	48.54	70.13	29.42	32.97	45.90	69.60	45.02	66.95	41.54

TABLE 5
ESTABLISHED PROGRAMS FINANCING
Projection of payments to provinces on basis of
half cash, plus half federal alcohol taxes, half tobacco taxes,
8½ points p.i.t., one point corporate tax
(Calculation 3)

	Nfld.	P.E.I.	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta	B.C.	Total
					(Millions of Dollars)						
1977-78	137.1	28.5	214.2	170.0	1,665.2	2,257.7	263.2	234.4	502.3	634.5	6,107.1
1978-79	158.1	33.2	243.3	196.9	1,868.1	2,550.8	298.4	270.2	570.3	737.6	6,926.8
1979-80	182.1	38.8	276.2	227.6	2,093.0	2,878.4	338.2	310.5	646.5	856.3	7,847.5
1980-81	206.3	44.4	309.1	258.8	2,309.5	3,197.8	377.3	351.5	721.9	978.6	8,755.2
1981-82	231.6	50.5	342.5	291.6	2,525.6	3,522.0	417.1	394.2	798.7	1,108.1	9,682.0
					(Per Capita in Dollars)						
1977-78	243.90	233.41	255.27	243.52	265.54	267.28	254.83	247.53	269.76	248.83	261.76
1978-79	278.38	269.61	287.89	278.06	296.47	297.93	287.52	281.41	300.00	282.50	293.30
1979-80	317.18	310.67	324.23	316.94	330.60	331.68	323.96	319.42	333.22	320.23	328.24
1980-81	355.61	352.04	359.47	355.47	362.96	363.56	359.32	356.84	364.40	357.28	361.66
1981-82	394.62	394.62	394.62	394.62	394.62	394.62	394.62	394.62	394.62	394.62	394.62
					(Annual Growth Rates in Percentages)						
1977-78	16.9	19.3	15.4	17.4	13.7	14.5	15.0	16.7	15.0	17.7	15.0
1978-79	15.4	16.5	13.6	15.8	12.2	13.0	13.4	15.2	13.5	16.2	13.4
1979-80	15.1	17.1	13.6	15.6	12.0	12.8	13.3	14.9	13.4	16.1	13.3
1980-81	13.3	14.2	11.9	13.7	10.3	11.1	11.6	13.2	11.7	14.3	11.6
1981-82	12.3	13.9	10.8	12.7	9.4	10.1	10.6	12.2	10.6	13.2	10.6

TABLE 5A

ESTABLISHED PROGRAMS FINANCING

Projection of difference between Calculation 3 (Half cash, plus half federal alcohol taxes, half tobacco taxes, $8\frac{1}{2}$ points p.i.t., one point corporate tax) and payments under continuation of existing arrangements

	Nfld.	P.E.I.	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta	B.C.	Total
					(Millions of Dollars)						
1977-78	3.8	1.8	5.8	8.5	39.6	63.2	7.8	11.4	31.3	33.8	207.0
1978-79	8.6	3.5	12.7	16.6	57.5	97.7	14.5	23.9	44.9	64.2	344.0
1979-80	16.9	6.0	22.5	27.9	108.1	162.2	26.7	38.7	61.9	103.5	574.3
1980-81	24.8	8.2	31.8	38.8	146.5	211.7	36.7	53.1	75.1	141.5	768.2
1981-82	34.2	11.2	42.1	51.8	188.3	271.0	48.5	69.5	91.1	188.0	995.8
					(Per Capita in Dollars)						
1977-78	6.71	14.56	6.88	12.14	6.31	7.48	7.59	12.05	16.81	13.26	8.87
1978-79	15.18	28.15	14.99	23.40	9.12	11.42	14.01	24.85	23.62	24.59	14.57
1979-80	29.37	48.27	26.46	38.80	17.08	18.69	25.59	39.80	31.88	38.70	24.02
1980-81	42.67	64.74	37.03	53.28	23.03	24.07	34.94	53.89	37.90	51.66	31.73
1981-82	58.33	87.59	48.54	70.13	29.42	30.36	45.90	69.60	45.02	66.95	40.59

TABLE 6
ESTABLISHED PROGRAMS FINANCING
Projection of payments on basis of half cash,
$12\frac{1}{2}$ points p.i.t., one point corporate tax
(Calculation 4)

	Nfld.	P.E.I.	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta	B.C.	Total
					(Millions of Dollars)						
1977-78	137.1	28.5	214.2	170.0	1,665.2	2,272.3	263.2	234.4	502.3	634.5	6,121.7
1978-79	158.1	33.2	243.3	196.9	1,868.1	2,554.7	298.4	270.2	570.3	737.6	6,930.7
1979-80	182.1	38.8	276.2	227.6	2,093.0	2,878.5	338.2	310.5	646.5	856.3	7,847.7
1980-81	206.3	44.4	309.1	258.8	2,309.5	3,212.8	377.3	351.5	721.9	978.6	8,770.1
1981-82	231.6	50.5	342.5	291.6	2,525.6	3,562.2	417.1	394.2	798.7	1,108.1	9,722.2
					(Per Capita in Dollars)						
1977-78	243.90	233.41	255.27	243.52	265.54	269.01	254.83	247.53	269.76	248.83	262.38
1978-79	278.38	269.61	287.89	278.06	296.47	298.38	287.52	281.41	300.00	282.50	293.46
1979-80	317.18	310.67	324.23	316.94	330.60	331.71	323.96	319.42	333.22	320.23	328.25
1980-81	355.61	352.04	359.47	355.47	362.96	365.26	359.32	356.84	364.40	357.28	362.28
1981-82	394.62	394.62	394.62	394.62	394.62	399.13	394.62	394.62	394.62	394.62	396.26
					(Annual Growth Rates in Percentages)						
1977-78	16.9	19.3	15.4	17.4	13.7	15.0	15.0	16.7	15.0	17.9	15.1
1978-79	15.4	16.5	13.6	15.8	12.2	12.4	13.4	15.2	13.5	16.2	13.2
1979-80	15.1	17.1	13.6	15.6	12.0	12.7	13.3	14.9	13.4	16.1	13.2
1980-81	13.3	14.2	11.9	13.7	10.3	11.6	11.6	13.2	11.7	14.3	11.8
1981-82	12.3	13.9	10.8	12.7	9.4	10.9	10.6	12.2	10.6	13.2	10.9

TABLE 6A
ESTABLISHED PROGRAMS FINANCING
Projection of difference between Calculation 4 (half cash, $12\frac{1}{2}$ points p.i.t., one point corporate tax) and payments under existing arrangements

	Nfld.	P.E.I.	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta	B.C.	Total
(Millions of Dollars)											
1977-78	3.8	1.8	5.8	8.5	39.6	77.8	7.8	11.4	31.3	33.8	221.6
1978-79	8.6	3.5	12.7	16.6	57.5	101.6	14.5	23.9	44.9	64.2	347.9
1979-80	16.9	6.0	22.5	27.9	108.1	162.3	26.7	38.7	61.9	103.5	574.5
1980-81	24.8	8.2	31.8	38.8	146.5	226.7	36.7	53.1	75.1	141.5	783.1
1981-82	34.2	11.2	42.1	51.8	188.3	311.2	48.5	69.5	91.1	188.0	1,036.0
(Per Capita in Dollars)											
1977-78	6.71	14.56	6.88	12.14	6.31	9.21	7.59	12.05	16.81	13.26	9.50
1978-79	15.18	28.15	14.99	23.40	9.12	11.87	14.01	24.85	23.62	24.59	14.73
1979-80	29.37	48.27	26.46	38.80	17.08	18.71	25.59	39.80	31.88	38.70	24.03
1980-81	42.67	64.74	37.03	53.28	23.03	25.77	34.94	53.89	37.90	51.66	32.35
1981-82	58.33	87.59	48.54	70.13	29.42	34.87	45.90	69.60	45.02	66.95	42.23

TABLE 7
ESTABLISHED PROGRAMS FINANCING
Projection of payments on basis of
one third cash, 12 points p.i.t., one point corporate tax,
one half alcohol taxes, one half tobacco taxes
(Calculation 5)

	Nfld.	P.E.I.	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta	B.C.	Total
					(Millions of Dollars)						
1977-78	137.1	28.5	214.2	170.0	1,665.2	2,257.7	263.2	234.4	502.3	634.5	6,107.1
1978-79	158.1	33.2	243.3	196.9	1,868.1	2,550.8	298.4	270.2	570.3	737.6	6,926.8
1979-80	182.1	38.8	276.2	227.6	2,093.0	2,878.4	338.2	310.5	646.5	856.3	7,847.5
1980-81	206.3	44.4	309.1	258.8	2,309.5	3,197.8	377.3	351.5	721.9	978.6	8,755.2
1981-82	231.6	50.5	342.5	291.6	2,525.6	3,522.0	417.1	394.2	798.7	1,108.1	9,682.0
					(Per Capita in Dollars)						
1977-78	243.90	233.41	255.27	243.52	265.54	267.28	254.83	247.53	269.76	248.83	261.76
1978-79	278.38	269.61	287.89	278.06	296.47	297.93	287.52	281.41	300.00	282.50	293.30
1979-80	317.18	310.67	324.23	316.94	330.60	331.68	323.96	319.42	333.22	320.23	328.24
1980-81	355.61	352.04	359.47	355.47	362.96	363.56	359.32	356.84	364.40	357.28	361.66
1981-82	394.62	394.62	394.62	394.62	394.62	394.62	394.62	394.62	394.62	394.62	394.62
					(Annual Growth Rates in Percentages)						
1977-78	16.9	19.3	15.4	17.4	13.7	14.5	15.0	16.7	15.0	17.9	15.0
1978-79	15.4	16.5	13.6	15.8	12.2	13.0	13.4	15.2	13.5	16.2	13.4
1979-80	15.1	17.1	13.6	15.6	12.0	12.8	13.3	14.9	13.4	16.1	13.3
1980-81	13.3	14.2	11.9	13.7	10.3	11.1	11.6	13.2	11.7	14.3	11.6
1981-82	12.3	13.9	10.8	12.7	9.4	10.1	10.6	12.2	10.6	13.2	10.6

TABLE 7A
ESTABLISHED PROGRAMS FINANCING
Projection of difference between Calculation 5 (one third cash, 12 points p.i.t., one point corporate tax, one half alcohol taxes, one half tobacco taxes) and payments under existing arrangements

	Nfld.	P.E.I.	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta	B.C.	Total
					(Millions of Dollars)						
1977-78	3.8	1.8	5.8	8.5	39.6	63.2	7.8	11.4	31.3	33.8	207.0
1978-79	8.6	3.5	12.7	16.6	57.5	97.7	14.5	23.9	44.9	64.2	344.0
1979-80	16.9	6.0	22.5	27.9	108.1	162.2	26.7	38.7	61.9	103.5	574.3
1980-81	24.8	8.2	31.8	38.8	146.5	211.7	36.7	53.1	75.1	141.5	768.2
1981-82	34.2	11.2	42.1	51.8	188.3	271.0	48.5	69.5	91.1	188.0	995.8
					(Per Capita in Dollars)						
1977-78	6.71	14.56	6.88	12.14	6.31	7.48	7.59	12.05	16.81	13.26	8.87
1978-79	15.18	28.15	14.99	23.40	9.12	11.42	14.01	24.85	23.62	24.59	14.57
1979-80	29.37	48.27	26.46	38.80	17.08	18.69	25.59	39.80	31.88	38.70	24.02
1980-81	42.67	64.74	37.03	53.28	23.03	24.07	34.94	53.89	37.90	51.66	31.73
1981-82	58.33	87.59	48.54	70.13	29.42	30.36	45.90	69.60	45.02	66.95	40.59

NOTES FOR AN ADDRESS

BY THE HONOURABLE MARC LALONDE

TO THE

CANADIAN HOSPITAL ASSOCIATION

"Health Policy and Financing -
Where have we come from?
Where are we going?

QUEBEC CITY
QUEBEC

Wednesday, May 11, 1977

Health
and Welfare
Canada

Santé et
Bien-être social
Canada

Ladies and Gentlemen:

Thank you for giving me the opportunity of speaking to you on the occasion of your 10th Annual Convention and 34th Annual General Meeting, here in Quebec City. I hope that it bodes well for our relationship that you have invited me back to be your keynote speaker and in any event the occasion is indeed timely as health policy and health financing arrangements in Canada have been going through an important transition period since I last spoke to you, two years ago, in Saskatoon.

I am certain that much of your interest is centred on the direction that will be taken in health policy in the future. I intend to give you my view of the developments from my perspective as the federal Minister responsible for both health and welfare. Before doing this, however, I would like to review briefly two important developments of recent years that have been important forces in the mapping out of future health policy.

The single most significant development in the health field in Canada over the last two decades has probably been the implementation of our universal health insurance system. As a consequence of the shared-cost programs legislated for hospital insurance in 1957 and for medical care insurance in 1966, Canadians have been provided with high quality and universal health care insurance. Impressive gains in health care have been made in Canada during the past twenty years as the universal health insurance program became a fundamental component of our social institutions in the eyes of Canadians.

I doubt that any government in this country questions the importance and fundamental strength of our basic health insurance programs. But within the basic structure of these programs, there have been several important concerns raised

in recent years. First, one had to seek the point at which the additional benefit from more and more hospital beds and physicians did not justify the rising costs of providing these higher levels of health services. Secondly, one had to question how long the open-ended, shared-cost arrangements only for the high cost institutional and physicians' services could be retained. The premise that the federal government would reimburse fifty percent of the provinces' expenditures, stimulated development and availability of health services but, at the same time, made it difficult for the provinces to restrain program costs in areas where a dollar of provincial expenditure automatically generated half a dollar in federal cost reimbursement.

No one - least of all this audience - would minimize the difficulty of slowing the rate of growth of health services and everyone is aware of the immense problems of adequately distributing the supply of health services. Thus, for example, I am sure that many rural areas in this country find it difficult to accept the generalization that the overall supply of health care services in this country is approaching an adequate level.

Nonetheless, there are a few statistics that stand out. Our overall hospital bed/population ratio for all types of beds has stabilized at about 9.1 beds per thousand population, so that sufficient accommodation is available to provide the average Canadian with about 3 days a year in hospital. Internationally, Canada's bed to population ratio is one of the highest among developed Western nations. In terms of general hospital beds alone, the most recent comparable figures for the year 1973 show Canada ahead of the United States and Great Britain with 5.6 general beds per thousand population as compared to 4.9 and 4.1 respectively.

The use Canadians make of hospitals is also striking. In fact, the Canadian rate of admission is among the highest in the Western world, with one out of every six Canadians being admitted to hospital each year.

Not surprisingly, hospitals represent more than half of total health care costs and close to two-thirds of all governments' health spending.

In recent months and years, you have seen all governments begin action to deal with these basic concerns while at the same time openly striving to retain the basic universal prepaid health insurance system. Thus, the efforts to reduce the rate of growth of hospital beds and the rate of inflow of immigrant physicians are examples of our co-operative attempts to deal with these problems as are a number of innovative steps taken by virtually all provincial governments to provide health care to their citizens in alternative, and often less expensive, forms. I am thinking of course of home care programs, ambulatory and multi-service centres, and residential and nursing home care programs.

As most of you may by now be aware, these considerations led federal and provincial governments to consider substantial modifications to the form of the federal financial contributions to provincial health care programs. These new arrangements, called Established Programs Financing, have been implemented as of April 1, 1977. They will ensure that the national character of the health programs will be retained while at the same time providing the provinces with the flexibility to meet their particular program requirements.

The federal equal per capita cash contribution to the provinces for Hospital Insurance and Medical Care will continue to be conditional upon the provinces meeting the

basic health program conditions of comprehensiveness, universality, portability, accessibility and non-profit administration by a public agency. But the federal contribution will no longer be tied to the exact health program costs incurred in each province. Further, it will reduce the detailed administrative requirements that existed with the shared-cost arrangements.

The new financial arrangements for Hospital Insurance and Medical Care are being complemented by a federal financial contribution of $20 per capita to each province towards the cost of alternative forms of health care delivery such as home care, ambulatory care and various forms of residential care in the hopes of supporting initiatives along those lines being taken in most provinces.

I would like to point out here, the significance of health care delivery in the containment of rising health care costs. Evidence suggests that the greatest opportunity now to contain hospital costs may be to reduce inappropriate use of hospitals.

For example, it is likely that some Canadians are still being admitted to hospitals when they needn't be and, among other reasons for this can be the desire for "free" hospital-based care where alternative forms of care are not state provided.

The number of days a patient stays in a hospital is another area in need of resolve. The Canadian median is 8.8 days, but there is a variation of about one-third between the longest and shortest average length of stay among the provinces. For surgical procedures the range is even more striking: 37% for births, 50% for removal of gallbladders and over 100% for a particular kind of eye operation.

Some of these differences may be explained by lack of convalescent homes in the area, or the lack of a home care

program; situations that could be remedied under the new financial arrangements for health care programs. I must add, however, that there are of course other reasons for the occurrence of these situations. You in the Canadian Hospital Association, are I am sure aware of them, and I hope, in fact, feel confident, that you are doing your part to correct them. At approximately $140 a per patient day, unnecessary time in the hospital is too costly a luxury.

In general, then, the new financial arrangements for the health care programs provide flexibility to the provinces in their program decisions within the broad confines of national health program conditions that are subscribed to by all the provinces as well as by the federal government.

Finally, on this point, I would like to note that the new financial arrangements will assure greater equality among the provinces in what they receive from the federal government and will provide them with greater financing than they would have received under the old shared-cost arrangements for the health programs. Including both post-secondary education and the health programs, the additional entitlement being made to the provinces is estimated at over $900 million for 1977/78 alone.

To this point I have noted only the first major development, that is, the implementation and maturation of the universal health care system and the recent introduction of a new federal/provincial financial arrangement. The second event, a much more recent one, has been the realization that a shift of emphasis was required from the treatment of illness to the prevention of illness or, more positively, the promotion of health.

Without minimizing whatsoever the significance of the patient care system as a major contribution to the well-being of Canadians, we have increasingly come to realize

... 6

that many of the causes of premature mortality could be attacked much closer to the source of the problem. I note, for example, the contribution of abuse of alcohol, excessive speed and failure to wear seatbelts to the heavy toll taken by motor vehicle accidents. I think also of the influence of smoking, inappropriate diet and the lack of physical exercise in the case of heart disease. In effect many Canadians are digging their own graves by their choice of lifestyle, or "with their own teeth" as one doctor said after looking at the results of a nutrition and diet study.

It can be clearly seen that to extend the concept of health to prevention and the promotion of good health we must do more than simply expand and improve our basic health care system. In fact the basic factors upon which we must act are those related to the social and physical environment and those related to our personal habits.

A most rudimentary illustration of this can be taken from the experience in South Carolina's coastal Low Country. There, health problems are so closely linked to environmental and social problems that the U.S. government working to improve health - not only treated the children debilitated by worms, but also installed plumbing facilities in their homes so they would not ingest the eggs again; treated heart disease, but also worked to alter diet; treated pneumonia, but also weatherproofed houses; treated feverish babies, but also told the mothers about flies, and screened the houses.

The presence of health facilities alone could not solve the health problems. As one doctor said of the areas where such environmental and social help had not come yet; "We just haul the people into the clinic every day. Then we take them back to the shack with no toilet or water. When they get sick again, we bring them back over here".

... 7

Here in Canada, both my officials and I are concerned about the influence of adverse environmental factors upon the health of our native people. As most of you are aware, the federal government has traditionally arranged, through my Department, the provision of health services to large segments of the native population. In so doing, we have become increasingly aware that in order to have complete success in improving the health status of the native people, radical improvements must be made in their physical environment in the areas of housing, water supply, sewage and other forms of waste disposal. The facts are clear - there is a direct relationship between the physical and mental health of the people and their immediate external environment.

Having expressed this concern, I am pleased to be able to report that my health officials have been meeting with their counterparts in the Department of Indian Affairs in an effort to improve the present situation. There is a basic agreement between the two departments that a co-operative approach to the improvement of the environment of the native is an imperative. While I am happy progress has been made, much remains to be done.

I used these examples to show how very basic the relationship between health, and the social and physical environment can be. Less visible problems, such as those of lifestyle, are harder to identify and influence, but no less devastating in their effect on health.

Federal and provincial governments, often in conjunction with full participation from interest groups, individuals, unions and industries, have already initiated the very difficult action of reaching out into the less tangible problems of the social and physical environment to attack the causes of morbidity and mortality. The

... 8

introduction of seatbelt laws and the lowering of speed limits are two such initiatives. Early efforts have also begun to fully inform Canadians of the risks they voluntarily accept by selecting a lifestyle that will eventually contribute to premature mortality or a fight with sickness that might have been avoided.

I believe the health industry, and I use that term very broadly, is at an interesting stage in this shift of emphasis towards health promotion as the next major initiative to improve the health and well-being of Canadians. We have gone through that early conceptual stage when the idea becomes implanted in the policies of health advocates. I doubt that many people question the basic premise that both society and the individual must reach down beyond the symptoms to the causes of many of our health problems. I believe we have succeeded in this stage of our work. The next stage, the successful implementation, is much more difficult.

So far I have talked about two major developments that have contributed to the present need to rethink and restructure to some extent our health policies. Both of these developments have been success stories. First, came the implementation and maturation of a first-class health care delivery system. Second, came the realization that the next major gain in health and well-being will be achieved by opening the battle on a new front - the health promotion front.

Since we are moving forward from an already successful position, it is easy to look to future health policies with a very positive perspective. I am personally confident that much can still be done to improve the health and well-being of Canadians without having to devote an increasingly large component of our national income to this sector.

In view of these considerations, then, I would like to outline briefly the continuing role that I see for the federal government both in the health care system and in the new battle to promote good health for Canadians.

First, I want to emphasize that introduction of new federal/provincial financial arrangements for the basic health care programs should <u>not</u> be seen as an abdication by the federal government of an interest in improving the overall quality of the Canadian health care system. The untying of the federal financial contribution from direct program costs has not resulted in a reduction in the level of our financial contribution ... indeed, it has increased substantially. Moreover, our efforts to cooperate with the provincial departments and with health groups to improve the quality of health care will be increased, not contracted, in the coming years.

By way of example, I would like to point to several aspects of our on-going work program that will be continued. In the area of health manpower, we have had an excellent cooperative experience in the evaluation of physician manpower requirements for Canada. This work has just begun - much is still required if we are to deal with health manpower distribution problems and with the implementation of policy instruments to facilitate the matching of the supply of manpower with the demand for these people. The importance of immigration and the free-flow of manpower among the provinces clearly indicates that this is a problem that must be dealt with cooperatively by all participants in the health industry.

Similarly, there is cooperative work to be pursued in the improvement of health standards, of health research and of the planning and evaluation of alternative methods of delivering health care to Canadians.

... 10

On the second front, the battle to change the social and physical environment and to inform Canadians of the implications of lifestyle choices has just begun. The Federal/Provincial Priorities Committee has already become deeply involved in work on alcohol abuse, occupational health, and traffic injuries. My Department has initiated an information program called "Operation Lifestyle", with such components as Dialogue on Drinking and the Lifestyle Profile. Similarly many provincial governments are undertaking initiatives in these areas.

This work will continue and will be expanded over the coming months and years, but its complexity and difficulty can best be understood by noting how deeply into the social structure we must reach if we are to be successful.

Any effort to change the social and physical environment leads us to attempt to act on social systems outside the direct aegis of the health system. I might use the alcohol problem as one example of this difficulty: among the broad spectrum of actions that might be imagined for decreasing the harmful effects of drinking to excess one might consider teaching programs in schools, stiffening the highway safety code, change in the drinking age, control of advertising, price increases and so on. All of these measures require the assistance or agreement of all sorts of public and private institutions outside any single health department and even outside the health care system. We are, on this new battleground, no longer within the one system, where we often have had direct means of control, action and prevention. Action must be more through persuasion and negotiation. We can no longer translate our desires into action with simple administrative decisions.

You will recognize, I think, that this is an unmapped policy area, fraught with difficulties for governments and for society. There are many unanswered questions in this field. For example, just how far ought we to go in intervening in the choice by Canadians of their food and their lifestyle?

What about occupational health? We already are engaged in health promotional activities in this area - for example, through the development of the Canadian Centre for Occupational Safety and Health, and many enlightened employers are cooperating with us. But not all employers are enlightened and not all workers are aware of the possible dangers in their workplace. And most Canadian workers are still not organized in unions devoted to taking up this cause. How far should we or the provinces go in regulating working conditions? How long should we try promotional activities before we move to stronger sanctions.

For the reality is simply that to deal with certain lifestyles is tantamount to attempting to alter certain cultural characteristics of our society. This is not only a complex and difficult operation but a very delicate one, which presents considerable ethical and philosophical problems.

The battle plan for this fight for health promotion does not include, and I want to stress this fact, authoritarianism or coercion. We are not returning to an era of prohibition. Rather, we hope to make gains in the promotion of good health by seeking a proper balance between the use of regulations such as speed limits and seatbelt laws and informed choice by Canadians. Most of the gains in lifestyle will have to be achieved by ensuring that Canadians have the necessary information about the consequences of their

... 12

lifestyle. Only in this way can they rationally and voluntarily stop smoking, eat more nutritious food, avoid alcohol abuse or take a nice long walk.

I have concentrated to some extent on the identification of the difficult task we all face in this next phase of improving the health of Canadians. Identifying the problems should not be confused with a lack of resolve to get on with the task ahead of us. Indeed, the very complexity of the task makes it all the more interesting and significant.

These are difficult questions and difficult problems and they cannot be solved without one vital ingredient. The ingredient is cooperation. My Department can do little to improve the quality of health care, to resolve problems in the physical and social environment, or to improve the lifestyle of Canadians without the active cooperation of provincial agencies, other federal agencies, health professionals and, mostly, individual Canadians. Similarly, these groups must expect cooperation from the federal health department in these areas. I can assure you that National Health and Welfare intends to cooperate fully in these enterprises. I am confident that all other parties have a similar attitude.

I am pleased to have had an opportunity to review the evolution of health policy and to look to the challenge ahead of us. I look forward to the gains yet to be made in the improvement of the health status of Canadians. I am certain this Association has an equally optimistic outlook and will continue to be an important and positive force in the health industry.

Thank you.

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